JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

THURSDAY, FEBRUARY 9, 1961

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

The committee met at 10 a.m. pursuant to call, in room P–63, the Capitol, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Bolling, Reuss, Griffiths, Curtis, Kilburn and Widnall, Senators Sparkman, Proxmire, Bush and Javits.

Also present: John W. Lehman, clerk and acting executive director.

The CHAIRMAN. The committee will please be in order.

Today we begin hearings on the 1961 Economic Report of the President.

Under the Employment Act of 1946, the President's economic report is referred each year to the Joint Economic Committee, which is to review the report and, in the words of the act:

"* * * file a report with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report, and * * * make other reports and recommendations to the Senate and House of Representatives as it deems advisable.

The situation this year is unusual in that the President's economic report was filed by the outgoing President. The only other time this circumstance has occurred was when President Eisenhower took office in 1953. At that time there was a delay in the appointment of the President's Council of Economic Advisers and no Joint Economic Committee report was filed.

This year, the Council of Economic Advisers was appointed soon after the President's inauguration on January 20, and several economic messages from the incoming President have already been received by the Congress.

The current hearings, therefore, will cover the report filed by President Eisenhower and the economic message of President Kennedy.

This morning, however, we are mainly concerned with getting the opinions of a panel of experts on the current economic situation and outlook.

All of these gentlemen have appeared before the Joint Economic Committee on this and similar subjects previously and we welcome their counsel again.

In order to allow maximum time for questioning, and to be fair to all witnesses, I am going to ask that you adhere strictly to the 10-minute rule in your opening statements.

Without objection, your full statements will, of course, appear in the printed record.

Mr. Paradiso, will you please lead off.

STATEMENT OF LOUIS J. PARADISO, ASSISTANT DIRECTOR-CHIEF STATISTICIAN, OFFICE OF BUSINESS ECONOMICS, U.S. DEPARTMENT OF COMMERCE, WASHINGTON, D.C.

Outlook for Federal, State, and Local Government Expenditures, and for Inventories, Plant and Equipment

Mr. Paradiso. Mr. Chairman, members of the committee, I have prepared a brief statement in response to your request, recasting the 1962 budget submitted by President Eisenhower on January 16, 1961, into the framework of the national income and product accounts.

Also, following your request, I shall comment briefly on recent developments in business investment outlays.

First, I shall move to the Government fiscal position 1961–62. A recasting of the budget is needed to assist in evaluating the impact of the Government operations on the total economy.

To complete the picture on total government activities a statement is also included for State and local governments.

In the calendar year 1960 Federal expenditures on income and product account, and, by the way, these include purchases of goods and services, transfer payments, interest payments, grants-in-aid, and subsidies, totaled $92 billion.

They were up nearly $1½ billion from 1959.

However, Federal purchases of goods and services amounting to $52 billion in calendar 1960 were $1 billion lower due to reductions in national defense outlays.

The latter drifted downward from mid-1959 to mid-1960.

The Federal expenditures other than for goods and services, in contrast, increased $2½ billion due primarily to higher unemployment compensation and old age benefit payments.

The downtrend in Federal purchases of goods and services was reversed after mid-1960. In the fourth calendar quarter of 1960, at an annual rate of $53 billion, these were up $1½ billion from the June quarter of that year.

State and local government expenditures totaled $51 billion in calendar 1960, advancing $3½ billion from the 1959 total, an increase about in line with the average or recent years.

These expenditures have grown at a more rapid rate than Federal expenditures.

For example, in 1957, they comprised 34 percent and in 1960, 37 percent of all government expenditures.

The January budget on the income and product account basis yields the following salient points:

One: Federal expenditures, on income and product basis, in the fiscal year 1962 are estimated at $98 billion, a rise of $2½ billion from the indicated total for fiscal 1961, and more than $6½ billion above the actual expenditures for the fiscal year 1960.

As you will recall, the administrative budget expenditures were estimated at $82.3 billion for fiscal year 1962.

Mainly because these do not include transactions of the trust funds, the budget expenditures are considerably less than those on the income and product, or cash budget basis.

Two: The portion of gross national product going to the Government is indicated by the purchase of goods and services which are made by Federal and other agencies.

The Federal buying of goods and services totaling $55½ billion in fiscal 1962 compares with an estimate for the current fiscal year 1961 of $53½ billion, and an actual outlay of $52½ billion for the fiscal year 1960.

Table 1 in this connection shows some of the details.

The overall estimate for fiscal 1961 is precisely the same as that projected in the President's budget submitted in January 1960.

The annual rate for the first half of fiscal 1961, this would be the average of calendar third and fourth quarters of last year, was $53 billion.

The total of $53½ billion for the full fiscal year 1961, implies a rise to an average annual rate of $54 billion for the first half of this calendar year 1961.

Moreover, during the coming fiscal year 1962, a further rise in Federal purchases is indicated at about the same rate as in recent quarters.

On this basis scheduled Federal purchases of $54½ billion for calendar 1961 is implied.

This is up, by the way, $2½ billion from the calendar 1960 total.

Three: Most of the estimated increase in purchases in the remainder of this fiscal year and during the ensuing fiscal year is scheduled to occur in defense spending.

For fiscal 1962 national defense expenditures are estimated at $47½ billion, up $1½ billion from the fiscal year 1961 total.

In the fourth quarter of 1960, the quarter just passed, actual defense expenditures were running at an annual rate of about $45½ billion so that some stepup is implied between now and the middle of next year.

Most of the increases will be for the expansion of space exploration activities, further shifts to guided missiles from manned bombers, and increased work on Polaris submarines and ships.

Scheduled ordering by the Defense Department for fiscal 1961 for major procurement items, research and construction, is expected to rise by $4 billion over the 1960 fiscal year according to the budget.

Since last June orders have been placed at an accelerated pace; the plans underlying the budget call for some decline in total ordering for fiscal 1962.

Four: Outlays for Federal expenditures other than for purchases of goods and services are expected to show only a small rise.

These are estimated at $42½ billion in fiscal 1962, up one-half billion dollars from the fiscal 1961 total, but $3½ billion above the actual outlay for fiscal 1960.

Higher payments under the social security system will be partially offset by the assumed reduction in unemployment compensation payments.

Changes in other categories of expenditures are mostly offsetting.

This completes the expenditure side.

Now, briefly the picture on Federal receipts.

One: In fiscal 1962 Federal receipts on income and product account basis are estimated at $101½ billion, up $3½ billion from fiscal 1961, and $8 billion above the actual receipts in fiscal 1960.

The increase in receipts in both the administrative and cash budget is roughly of the same magnitude as that on an income and product account basis.

Two: The fiscal 1962 increase in receipts given in the January budget message of President Eisenhower is predicated on an assumed substantial recovery in economic activity during 1961.

The following assumptions of the Treasury Department and Bureau of the Budget for the calendar year 1961 underlie the revenue estimates:

A. Personal income of $415 billion;

B. Corporate profits before taxes of $46 billion.

C. A gross national product between $510 billion and $520 billion, but closer to the $515 billion total.

Three: Exhibit 2 shows these broad measures related or basic to Federal Government receipts.

The annual rate of gross national product in the fourth quarter of last year was $503½ billion, about equal to the third-quarter rate.

Corporate profits before taxes in the third quarter of last year were at an annual rate of $46½ billion.

This is the most recent period for which profit data are available.

The wide swings in these profits show up very clearly in exhibit 2, which is attached to the end of this statement.

Four: Finally, the latest official estimate of personal income is for December of 1960 when it was at a seasonally adjusted annual rate of $406½ billion compared with the total for the year of 1960 of $404 billion.

The last section of exhibit 2 shows the major shifts which have recently taken place in this broadest of monthly indicators.

Note that the manufacturing payrolls have been in a downward phase since last midyear. This paralleled declines in factory employment and production.

Other income flows, however, were either rising or stable through October of last year and more than offset reductions in manufacturing.

As a result, total personal income increased steadily through October. Since November, however, declines in incomes have become more widespread and the total income flow has dropped.

Now, as to the Federal surplus, on income and product account basis, there is an indicated surplus in the budget of $3½ billion in fiscal year 1962.

This is $1 billion larger than the estimate of $2½ billion for fiscal 1961, which in turn was about the same as the actual surplus for fiscal 1960.

Now, I will turn to State and local governments.

Data similar to those on the Federal budget are lacking for State and local government agencies. For these agencies we have utilized the available information on construction programs and for the remainder we have relied upon an extension of recent trends which have been relatively stable.

We are not in a position to make any calculations which would take into account any special factors affecting the programs of these governments.

As exhibit 1 shows, State and local expenditures consist mostly of purchases of goods and services in contrast to the Federal Government where outlays other than for goods and services comprised over two-fifths of total expenditures in 1960.

Based on the foregoing considerations, purchases of goods and services by State and local governments are projected to a total of $51 billion in calendar 1961, up $3½ billion from the actual total in 1960.

Most of the 1961 increase is concentrated in the compensation of employees.

In the fourth quarter of calendar 1960, these purchases were running at an annual rate of $49 billion.

Receipts by State and local governments using the same basic economic assumptions as those used in the Federal budget, would rise about $4 billion in calendar 1961 over calendar 1960.

These governments, as you know, have had deficits in recent years and these estimates of expenditures and receipts imply a further deficit of $3 billion in calendar 1961.

Now, in summary, to button up these calculations, purchases and services by all governments in this calendar year 1961 would be, granting the assumptions stated, $105½ billion, or $6 billion more than in calendar year 1960.

This is one-fifth of the assumed gross national product about the same proportion as in the recent past.

Mr. Chairman, I have also been asked to cover rather briefly the expenditures by business on plant and equipment, and inventories and if you will permit me, I would like to go ahead on that section.

The CHAIRMAN. Yes, sir; you have a fine statement here. The complete statement will be inserted in the record.

Mr. PARADISO. Thank you.

I am now going to move on to business expenditures for plant and equipment.

During 1960 businessmen spent close to $36 billion on new plant and equipment, some 10 percent more than in 1959, but somewhat below the peak outlays reached in 1957.

In other words, we did not get back to the 1957 level.

Expenditures increased throughout the first half of last year.

However, because earlier expectations of sales increases did not materialize, because profits turned down, and for other reasons, businessmen reduced their purchases in the third and fourth quarters.

Now, I might summarize this briefly since I notice my time is already up, by saying that we have very little information that is new on plant and equipment spending by business since I testified here last December.

We do have information on new orders received by the industrial machinery companies and these orders are drifting down, but not at a sharp pace.

So I will just conclude from the new evidence, which is rather skimpy up to this point, that fixed investment is moving downward in the first quarter of this year and there is at the moment no indication of a turnaround in this very dynamic sector of the economy.

Now, just a word on inventories. Business inventory movements have been, as you know, quite important in the economic developments of recent months. Essentially and just to summarize in a few words these estimates, what has happened is this: Businessmen have been liquidating inventories, particularly in the manufacturing area, for some months.

The liquidation has been concentrated primarily in the raw materials and goods in process inventories, but at the same time there has been some accumulation of finished goods stocks. Thus, the inventory picture at the moment is that further liquidation is indicated, particularly because businessmen have a considerable volume of finished goods stocks on hand.

This is true not only in manufacturing, but as you know, in the case of automobile dealers their stock of new cars is now in excess of 1 million and these are excessive in relation to sales and auto builders are trimming down their production in order to match output with demand.

In summary, there is no indication of a turnabout in the trend of liquidation which has been continuing in the last several months.

Thank you.

(The formal statement of Mr. Paradiso follows:)

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

Mr. Chairman and members of the committee, I have prepared a brief statement, in response to your request, recasting the 1962 budget, submitted by President Eisenhower on January 16, 1961, into the framework of the national income and product accounts. Also following your request, I shall comment briefly on recent developments in business investment outlays.

Government Fiscal Position, 1961–62

A RECASTING OF THE JANUARY 1961 FEDERAL BUDGET INTO THE NATIONAL INCOME AND PRODUCT ACCOUNTS

A recasting of the budget is needed to assist in evaluating the impact of Government operations on the total economy. To complete the picture on total Government activities, a statement is also included for State and local governments.

In the calendar year 1960, Federal expenditures (on income and product account) totaling $92 billion, were up nearly $1½ billion from 1959. However, Federal purchases of goods and services were $1 billion lower due to reductions in national defense outlays. The latter drifted downward from mid-1959 to mid-1960. The rise of $2½ billion in other Federal expenditures occurred mainly in increased unemployment compensation and old-age benefit payments. The downtrend in Federal purchases was reversed after mid-1960; in the fourth calendar quarter of 1960 at an annual rate of $53 billion these were up $1½ billion from the June quarter of last year.

State and local government expenditures totaled $51 billion in calendar 1960, advancing $3½ billion from the 1959 total—an increase about in line with the average of recent years. These expenditures have grown at a more rapid rate than Federal expenditures. For example, in 1957 they comprised 34 percent, and in 1960, 37 percent, of all Government expenditures.

The January budget on the income and product account basis yields the following salient points:

Federal expenditures

1. Federal expenditures on a GNP basis in the fiscal year 1962 are estimated at $98 billion, a rise of $2½ billion from the indicated total for fiscal 1961, and more than $6½ billion above the actual expenditures for the fiscal year 1960. As you will recall, the administrative budget expenditures were estimated at

$82.3 billion for fiscal 1962. The budget expenditures are considerably less than those on the income and product or cash budget basis, mainly because these do not include transactions of the trust funds.

2. The portion of GNP going to the Government is indicated by the purchases of goods and services which are made by Federal and other agencies. The Federal total of $55½ billion in fiscal 1962 compares with an estimated total for the current fiscal year—1961—of $53½ billion, and an actual expenditure of $52½ billion for the fiscal year 1960. (See exhibit 1.) The overall estimate for fiscal 1961 is precisely the same as that projected in the President's budget submitted in January 1960. The annual rate for the first half of fiscal 1961 (average of calendar third and fourth quarters of last year) was $53 billion. The total of $53½ billion for the full fiscal year 1961 implies a rise to an average annual rate of $54 billion for the first half of calendar 1961. Moreover, during the coming fiscal year 1962, a further rise at about the same rate as in recent quarters in Federal purchases is indicated. (See table 1.) On this basis, scheduled Federal purchases of $54½ billion for calendar 1961 is implied.

3. Most of the estimated increase in purchases in the remainder of this fiscal year and during the ensuing fiscal year is scheduled to occur in defense spending. For fiscal 1962, national defense expenditures are estimated at 47½ billion, up $1½ billion from the fiscal 1961 total. In the fourth quarter of calendar 1960, the annual rate of defense expenditures was about $45½ billion, so that some stepup is implied between now and the middle of next year. Most of the increases will be for expansion of space exploration activities, further shifts to guided missiles from manned bombers, and increased work on Polaris submarines and ships.

Scheduled ordering by the Defense Department for fiscal 1961 for major procurement items, research, and construction is expected to rise by $4 billion over the 1960 fiscal year, according to the budget. Since last June orders have been placed at an accelerated pace. The plans underlying the budget call for some decline in total ordering for fiscal 1962.

4. Outlays for Federal expenditures other than for purchases of goods and services are expected to show a small rise. These are estimated at $42½ billion in fiscal 1962, up one-half billion dollars from the fiscal 1961 total, but $3½ billion above the actual outlay in fiscal 1960. Higher payments under the social security system will be partially offset by an assumed reduction in unemployment compensation payments. Changes in other categories of expenditures are mostly offsetting.

Federal Receipts

1. In fiscal 1962, Federal receipts (income and product account basis) are estimated at $101½ billion, up $3½ billion from fiscal 1961 and $8 billion above actual receipts in fiscal 1960. The increase in receipts in both the administrative and cash budgets is roughly of the same magnitude as that on an income and product account basis.

2. The fiscal 1962 increase in receipts, given in the January budget message of President Eisenhower, is predicated on an assumed substantial recovery in economic activity during 1961. The following assumptions of the Treasury Department and Bureau of the Budget for calendar 1961 underlie the revenue estimates: (*a*) Personal income of $415 billion; (*b*) corporate profits before taxes of $46 billion; and (*c*) GNP between $510 and $515 billion but closer to $515 billion.

3. Exhibit 2 shows these broad measures related to Federal Government receipts. The annual rate of GNP in the fourth quarter of last year was $503½ billion, about equal to the third quarter rate. Corporate profits before taxes in the third quarter of last year were an an annual rate of $41.5 billion. This is the most recent period for which profits data are available. The wide swings in these profits show up clearly in exhibit 2.

4. Finally, the latest official estimate of personal income is for December of 1960 when it was at a seasonally adjusted annual rate of $406½ billion, compared with the total for the year of $404 billion. The last section of exhibit 2 shows the major shifts which have recently taken place in this broadest of monthly indicators. Note that manufacturing payrolls have been in a downward phase since last midyear. This paralleled declines in factory employment and production. Other income flows, however, were either rising or stable through October of last year, and more than offset reductions in manufacturing. As a result, total personal income increased steadily. Since November, however, declines in incomes have become more widespread and the total income flow has dropped.

Federal surplus

On an income and product account basis there is an indicated surplus in the budget of $3½ billion in fiscal 1962. This is $1 billion larger than the estimate for fiscal 1961, which in turn was about the same as the actual for fiscal 1960. The estimates of the surplus on the administrative and cash budgets bases are somewhat smaller than on an income and product account basis. This is mainly because corporate taxes are treated on an accrual basis in the national income and product rather than on a collection basis, and most loan transactions are excluded.

STATE AND LOCAL GOVERNMENTS

Data similar to those on the Federal budget are lacking on the fiscal position of State and local government agencies. For this we have utilized the available information on construction programs, but for the remainder we have relied upon an extension of recent trends which have been relatively stable. We are not in a position to make any calculations which would take into account any special factors affecting the programs of these governments. As exhibit 1 shows, State and local expenditures consist mostly of purchases of goods and services in contrast to the Federal Government where outlays other than for goods and services comprised over two-fifths of total expenditures in 1960.

Based on the foregoing considerations, purchases of goods and services by State and local governments are projected to a total of $51 billion in calendar 1961, up $3½ billion from the actual total in 1960. In the fourth quarter of calendar 1960, these purchases were running at the annual rate of around $49 billion. Most of the 1961 increase is concentrated in compensation of employees.

Receipts by State and local governments—using the same basic economic assumptions as used in the Federal budget—would rise about $4 billion in calendar 1961 over calendar 1960. These governments have had deficits in recent years, and these estimates of expenditures and receipts imply a further deficit of about $3 billion in calendar 1961.

In summary, purchases of goods and services by all governments in this calendar year 1961 would be—granting the assumptions stated—$105½ billion, or $6 billion more than calendar year 1960. This is one-fifth of the assumed GNP, about the same proportion as in the recent past.

BUSINESS EXPENDITURES FOR PLANT AND EQUIPMENT

During 1960, businessmen spent close to $36 billion on new plant and equipment—some 10 percent more than in 1959—but somewhat below the peak outlays reached in 1957.

Expenditures increased throughout the first half of last year. However, because earlier expectations of sales increases did not materialize, because profits turned down, and for other reasons, businessmen reduced their purchases in the third and fourth quarters.

The most recent OBE–SEC survey, issued in early December, showed that businessmen were scheduling a further decline in the first quarter of 1961—to an estimated annual rate of $35 billion. The annual survey for the full year 1961 will be completed early next month at which time we shall have evidence of the programs for the ensuing quarters.

Developments may also be viewed from the standpoint of actions businessmen take before expenditures are made; namely, the placement of orders. In general, new orders placed lead actual expenditures but not in a fixed pattern, with the amount of the lead depending on the type of equipment and the volume of the backlog. But the trend of orders placed is a useful guide.

New orders for nonelectrical machinery showed a mixed picture during 1960. During the first half of the year, these showed an essentially sidewise movement, running slightly in excess of sales, seasonally adjusted. Orders subsequently moved downward into September, at a level below the volume of seasonally adjusted sales. There was some pickup in ordering in the final quarter of the year, which had the effect of halting the decline in backlogs of industrial machinery, an important component of capital goods demand. Backlogs of nonindustrial machinery continued to decline but by small amounts.

In the case of electrical machinery—where defense goods bulk large—orders have been sufficient to maintain output at a high rate, though they moved irregularly below the level of sales in the first half of 1960. Midsummer witnessed very heavy ordering of defense equipment. Orders in the fourth quarter were running well below that rate and moderately below the pace in the first half. Defense contracts were placed in heavy volume again in December.

Construction contract awards for industrial and commercial building were well maintained during the second half of last year, on a seasonally adjusted basis.

The foregoing indicates that fixed investment is moving downward in the first quarter, with no current indication of a shift in the trend.

BUSINESS INVENTORY MOVEMENTS

The movement of business inventories has been one of the important factors affecting production and sales patterns, as well as the demand for labor. The extent of the inventory shifts in the past 12 months are indicated by the inventory component of the GNP.

In the first half of last year, business accumulated inventories at the annual rate around $8 billion, reflecting in part rebuilding of stocks depleted during the 1959 steel strike, and anticipation of the need for the higher sales expected. These expectations did not fully materialize, and inventory policies were adjusted accordingly. In the third quarter the inventory change was small and in the fourth quarter the inventory liquidation was at an annual rate of $4 billion. For the year 1960, business inventories rose $3⅓ billion.

In order to evaluate the nature of the recent inventory changes, the industry data provides some worthwhile material. These are available only in book value terms. Table 2 presents these data for the recent period.

At the end of 1960, the book value of stocks held by manufacturing and trade firms was $91½ billion. Manufacturing inventories comprised three-fifths of this total.

Manufacturers have accounted for the inventory liquidation thus far, and in particular the durable goods firms. The book value of factory stocks, seasonally adjusted, reached a peak of $55 billion in June of last year. The reduction during the third quarter was less than one-half billion and this was followed by an additional $1-billion liquidation during the final 3 months. The cutbacks paralleled declining sales. During the second half of 1960, nondurable goods producers' inventories were relatively stable for practically all major industry groups.

Also in manufacturing, the recent liquidation has centered in working stocks; i.e., purchased materials and goods in process (see exhibit 3). These reductions reflect not only the declining tendency in factory sales and orders experienced since early last year, but also the decision of producers to get along with a smaller relative quantity of purchased material stocks—a development which may have been accentuated in recent months.

A long-term downtrend in these stocks relative to a given volume of shipments has been apparent in the postwar period. In contrast, stocks of finished goods held by manufacturers increased throughout 1960. While the accumulation of these goods moderated in the fourth quarter, increases continued in the electrical and nonelectrical machinery industries and in many of the nondurable good industries.

Fluctuations in trade inventories last year were dominated by shifts in holdings by automobile dealers. Total trade stocks rose $1½ billion in 1960, with about two-thirds of the rise occurring in retail trade. These stocks continued to rise during the second half of last year, although as the year closed there were indications that accumulation of trade stocks may have come to a halt. Stocks of motor vehicle dealers, which had accounted for most of the overall increase in retail trade in 1960, showed little change in December, seasonally adjusted.

Automobile sales in December and January fell sizably from their high October–November rates, and production schedules have been reduced in an effort to keep auto dealers' stocks from rising above their current level of around 1 million domestic cars.

The trend of business inventories during the past 4 years is shown in exhibit 3.

To sum up, business inventories are now undergoing some liquidation. With sales continuing to decline, inventory-sales ratios have been rising. The ratio for finished goods stocks held by manufacturers is higher than at any time since mid-1958. There is no clear indication yet of an early reversal in inventory buying policies by businessmen, and what happens in this segment will be influenced by the trend of demand for final products.

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TABLE 1.—*Federal Government receipts and expenditures, 1960–62*

[In billions of dollars]

	Fiscal years		
	1960 actual	1961 estimated	1962 estimated
Administrative budget:			
Receipts	77.8	79.0	82.3
Expenditures	76.5	78.9	80.9
Surplus	1.2	.1	1.5
Cash budget:			
Receipts	95.1	99.0	103.1
Expenditures	94.3	97.9	101.8
Surplus	.8	1.1	1.3
National income and product account:			
Receipts	93.5	98.0	101.5
Expenditures	91.3	95.5	98.0
Goods and services	52.4	53.5	55.5
Transfer payments to persons	21.2	24.0	25.0
Other	17.7	18.0	17.5
Surplus	2.2	2.5	3.5

NOTE.—The difference between the administrative budget and the cash budget is largely accounted for by the inclusion in the latter of trust fund transactions. The national income and product account includes trust fund transactions, but differs in definition from the cash budget in several important respects. 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 for the lag between deliveries and payments for goods is incorporated.

Sources: Administrative and cash budgets from "Budget of the U.S. Government for the Fiscal Year Ending June 30, 1962"; national income and product data, Office of Business Economics, based on estimates in the budget.

TABLE 2.—*Business inventories and sales*

[In billions of dollars, seasonally adjusted]

	Inventories (book value, end of month)				Sales (monthly average)			
	December 1958	December 1959	June 1960	December 1960	1958	1959	1st half 1960	2d half 1960
All manufacturing companies	49.2	52.4	55.1	53.7	26.2	29.7	31.0	29.7
Durables	27.8	30.1	32.2	30.8	12.4	14.5	15.2	14.2
Primary metals	4.1	4.1	4.8	4.5	1.9	2.2	2.4	1.9
Machinery	8.9	9.9	10.6	10.3	3.8	4.5	4.8	4.6
Transportation equipment	6.5	7.2	7.5	6.9	2.7	3.3	3.5	3.4
Purchased materials	7.5	8.3	8.6	7.9				
Goods in process	11.3	12.1	12.8	12.1				
Finished goods	9.0	9.7	10.7	10.8				
Nondurables	21.4	22.3	22.9	22.9	13.8	15.2	15.8	15.6
Purchased materials	8.6	8.9	9.1	8.7				
Goods in process	3.0	3.0	3.1	3.1				
Finished goods	9.8	10.4	10.6	11.1				
Wholesale trade	12.0	12.6	13.0	13.2	11.1	12.3	12.5	12.2
Durables	6.3	6.6	6.9	6.7	3.9	4.6	4.6	4.3
Nondurables	5.7	6.1	6.1	6.4	7.2	7.7	7.9	7.9
Retail trade	24.0	24.3	25.3	25.4	16.7	18.0	18.4	18.2
Durables	10.8	11.0	11.8	11.9	5.3	6.0	6.0	5.8
Motor vehicles	4.2	4.3	5.1	5.3	2.8	3.3	3.4	3.0
Nondurables	13.2	13.3	13.5	13.5	11.4	12.0	12.4	12.4

Source: Office of Business Economics, Department of Commerce.

EXHIBIT 1

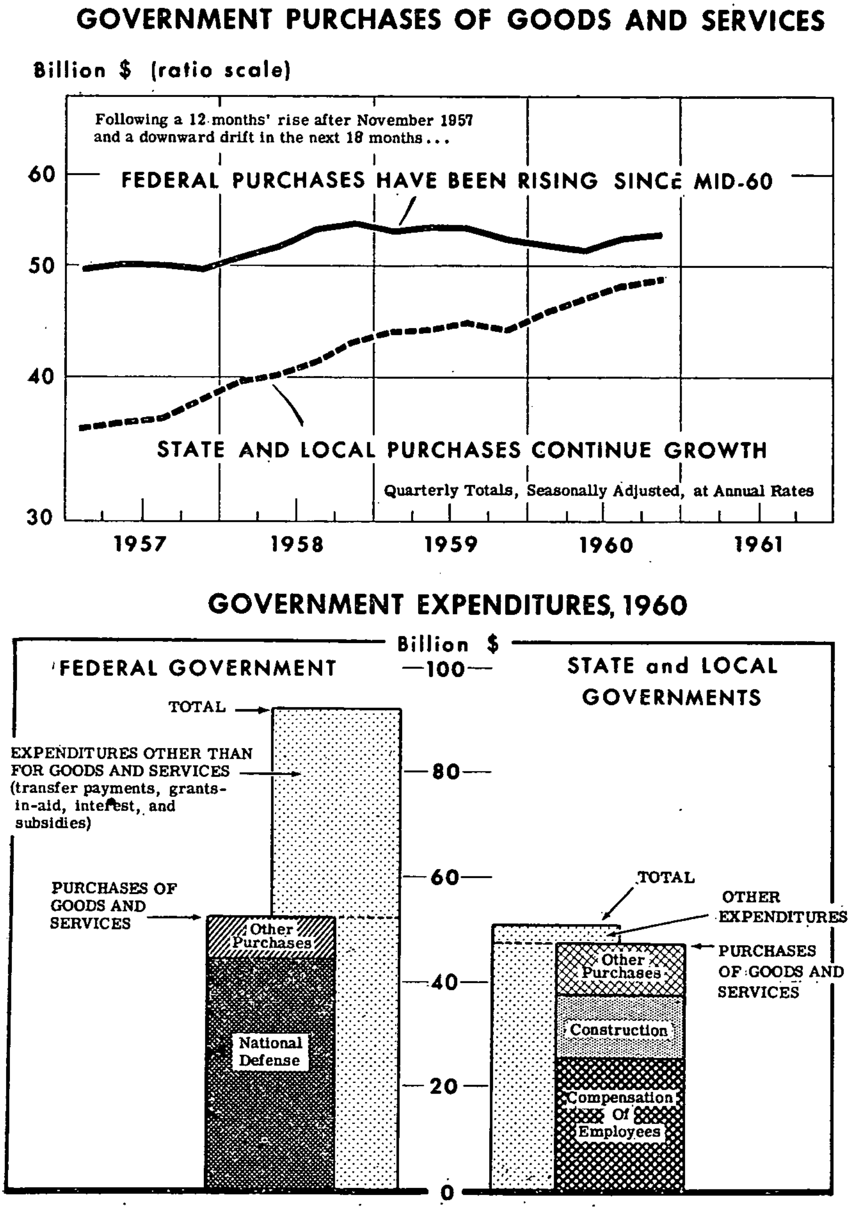
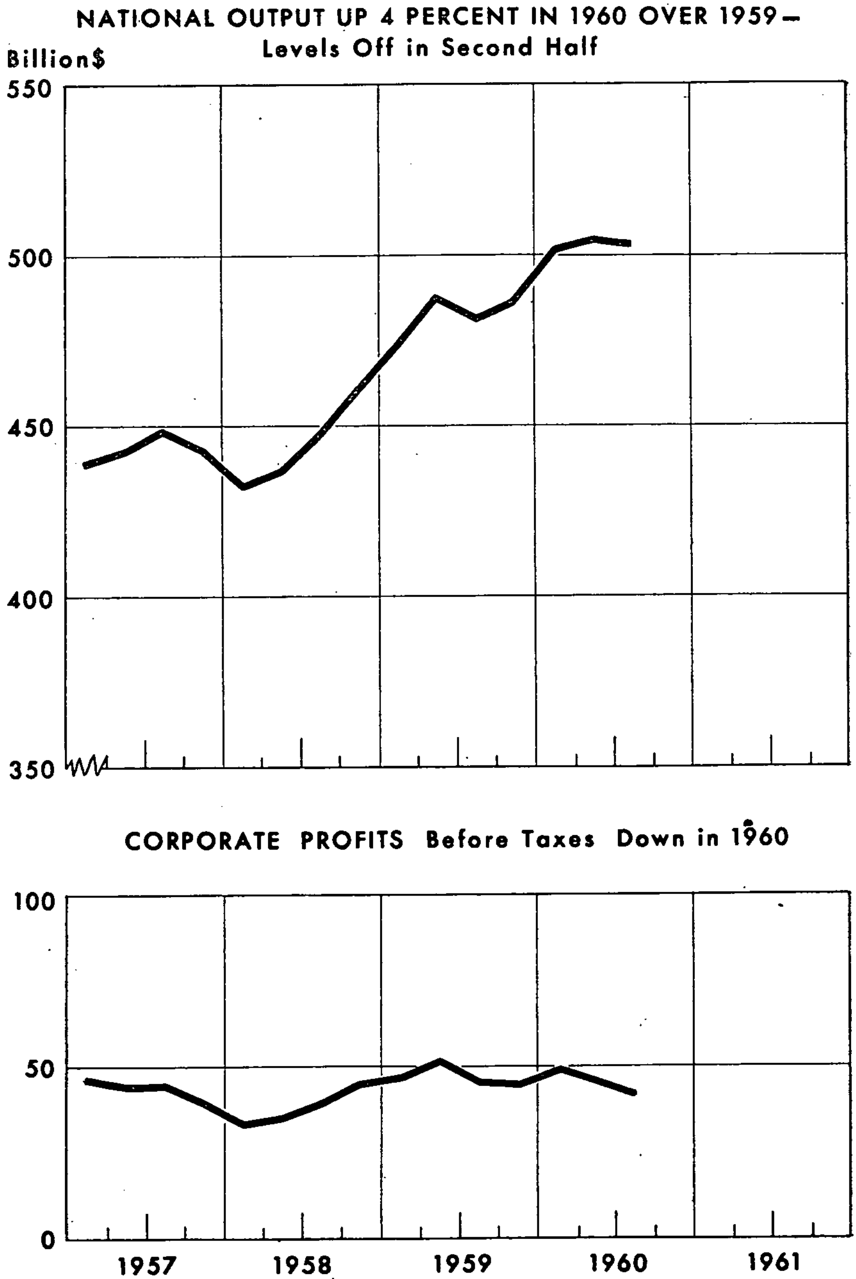
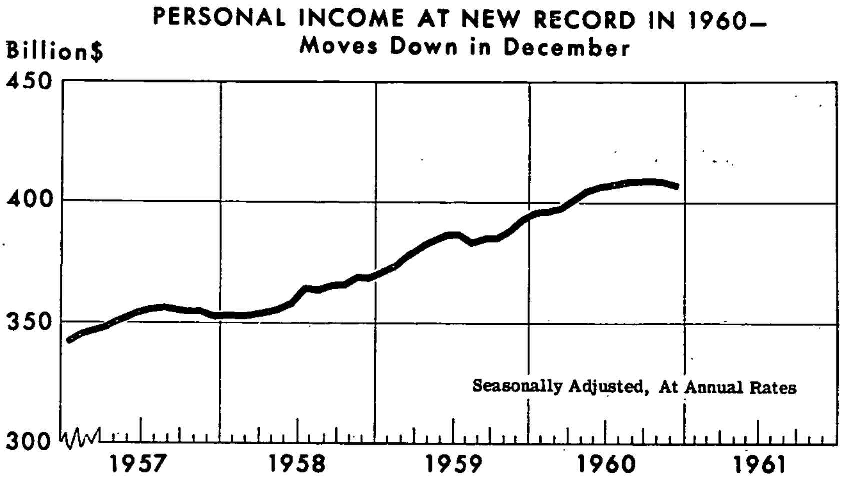

GOVERNMENT PURCHASES OF GOODS AND SERVICES
Billion $ (ratio scale)
Following a 12 months' rise after November 1957
and a downward drift in the next 18 months...
FEDERAL PURCHASES HAVE BEEN RISING SINCE MID-60
STATE AND LOCAL PURCHASES CONTINUE GROWTH
Quarterly Totals, Seasonally Adjusted, at Annual Rates
60
50
40
30
1957
1958
1959
1960
1961
GOVERNMENT EXPENDITURES, 1960
Billion $
FEDERAL GOVERNMENT
STATE and LOCAL GOVERNMENTS
100
80
60
40
20
0
TOTAL
EXPENDITURES OTHER THAN FOR GOODS AND SERVICES (transfer payments, grants-in-aid, interest, and subsidies)
PURCHASES OF GOODS AND SERVICES
Other Purchases
National Defense
TOTAL
OTHER EXPENDITURES
PURCHASES OF GOODS AND SERVICES
Other Purchases
Construction
Compensation Of Employees

Exhibit 2

BUSINESS INDICATORS BASIC TO GOVERNMENT RECEIPTS



Quarterly Totals, Seasonally Adjusted, At Annual Rates


PERSONAL INCOME AT NEW RECORD IN 1960–
Moves Down in December
Billion$
450
400
350
300
Seasonally Adjusted, At Annual Rates
1957
1958
1959
1960
1961

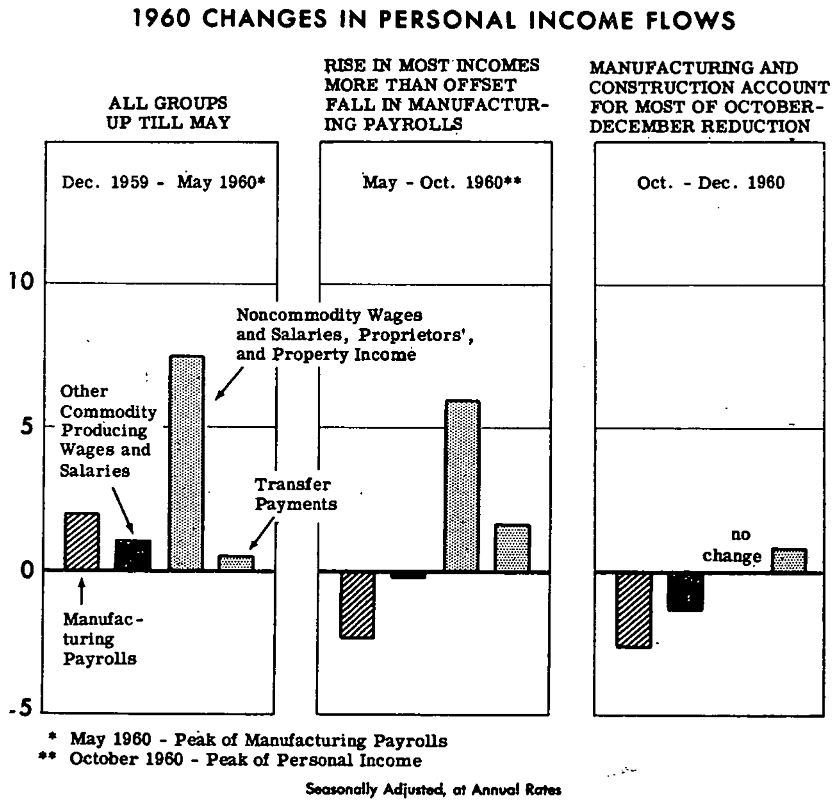
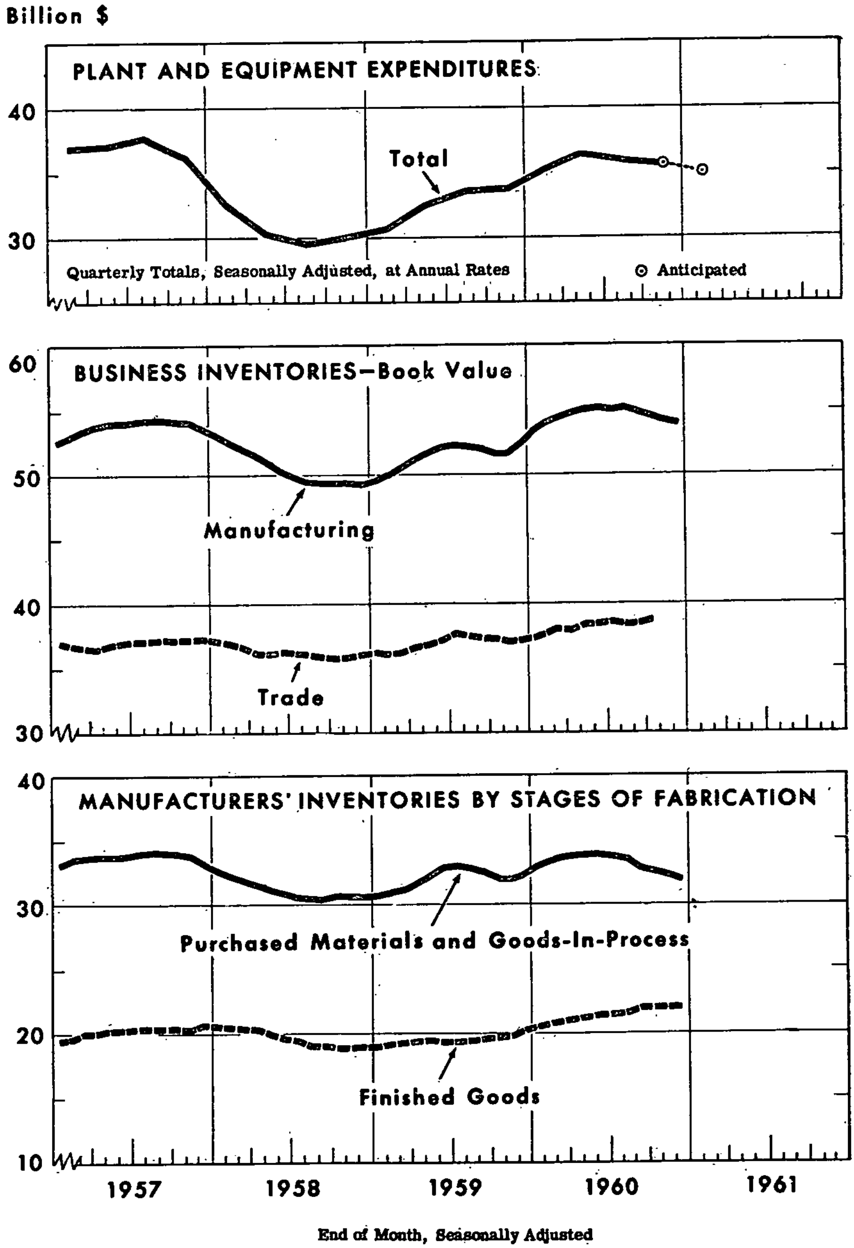

1960 CHANGES IN PERSONAL INCOME FLOWS
ALL GROUPS UP TILL MAY
RISE IN MOST INCOMES MORE THAN OFFSET FALL IN MANUFACTURING PAYROLLS
MANUFACTURING AND CONSTRUCTION ACCOUNT FOR MOST OF OCTOBER-DECEMBER REDUCTION
Dec. 1959 - May 1960*
May - Oct. 1960**
Oct. - Dec. 1960
10
5
0
-5
Noncommodity Wages and Salaries, Proprietors', and Property Income
Other Commodity Producing Wages and Salaries
Transfer Payments
Manufacturing Payrolls
no change
* May 1960 - Peak of Manufacturing Payrolls
** October 1960 - Peak of Personal Income
Seasonally Adjusted, at Annual Rates

Exhibit 3

BUSINESS INVESTMENT



The CHAIRMAN. Thank you, sir.

The next witness will be the vice president and chief economist of the F. W. Dodge Corp., of New York, Mr. George Cline Smith.

STATEMENT OF GEORGE CLINE SMITH, VICE PRESIDENT-CHIEF ECONOMIST, F. W. DODGE CORP., NEW YORK, N.Y.

OUTLOOK FOR HOUSING CONSTRUCTION AND CONSUMER EXPENDITURES

Mr. SMITH. Thank you, Mr. Chairman.

Comments on the general economic outlook for 1961: Economic conditions as of February 1961 can best be described as "mushy." A recession is clearly underway, and it shows signs of getting worse before it gets better.

On the other hand, some economic indicators show surprising strength, under the circumstances, offering good reason to expect that the downturn will be reversed before it gets too much deeper.

The movement downward into this recession has not been particularly sharp or clear cut.

By the same token, the recovery may not be as sharp or conclusive as we would like. Not all economic indicators will be moving in the same direction at once, or with the same enthusiasm.

If the recovery is somewhat less than satisfactory, there will be a good deal of pressure to do something. The danger may well be that we will go galloping off in all directions with antirecession measures whose combined force, when it eventually becomes effective, will start us off on a runaway inflationary boom with unfortunate consequences.

As this is being written at the height of the great blizzard of 1961, it is difficult to avoid using the analogy of an automobile starting up a snow-covered hill. Too heavy a foot on the accelerator may produce almost any consequences except the desired one of moving steadily upward under control.

In view of the likelihood that the current recession will moderate before long, the go-slow attitude expressed by the President, avoiding massive antirecession measures at this time, has much to recommend it.

In commenting on the outlook, I think it may be worth while to summarize briefly the opinions of the panel of leading economists whom we poll each November. I know that there is some skepticism of the value of opinion polls on the outlook, which has been referred to as "playing the numbers game," but I believe that this survey, now in its 14th year, has regularly pointed out the directions the economy would take in the shortrun future.

A year ago, in a statement to this committee, I summarized the opinions of the economists surveyed in 1959 this way:

> * * * 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 on readjustment in that year.

While individual opinions were divergent, it seems that as a group, the economists gave a reasonably good qualitative estimate of what lay ahead.

Last November we reported on the opinions of 327 leading economists in business, government, and universities on the outlook for 1961. We take these polls each year. This is the 14th consecutive year.

There have been no unforeseen economic developments of any great importance since then, and I think that the collective opinions of the economists are still applicable.

It is true that the election had not been decided when the opinions were surveyed, but there was a general feeling among the economists that the short-term outlook would not be greatly affected by the election result.

The great majority of the economists felt that the major economic indicators would decline during part of the forecast period. They had varying opinions as to when the low point would be reached, but nearly all felt that it would occur sometime in the first three quarters of 1961.

The significant point is that 90 percent of the economists thought that the gross national product would be rising again by the fourth quarter of 1961. Expectations about the index of industrial production were similar.

On the subject of prices, the economists were less unanimous than in past surveys in expecting continued inflation.

However, the majority expected that consumer prices would continue to rise, particularly in the second half of 1961, and that wholesale prices would go up very slightly.

They expected money rates to remain relatively stable throughout 1961; many felt that the international financial climate and the continued outflow of gold would hamper efforts of the monetary authorities to ease credit generally.

My own impression is that these estimates describe the probable pattern fairly well. I expect, however, that the major indicators will go down somewhat more than the median estimates of the economists, and that while there will be an upturn in late 1961, it will not be of runaway proportions. Any real recovery will come in 1962, and even then, some major lines of activity will probably not be operating at record levels. And unemployment will probabily be higher than we would like for some years to come.

We have enjoyed 15 years of unbridled postwar boom, a period in which even the recessions were relatively prosperous. There is no prospect whatever of a great postwar depression, but we may have to face up to some readjustments, particularly stemming from the age makeup of our population, which will give us a period of somewhat unsatisfactory prosperity. In short, the opening years of the sixties do not promise quite the buoyancy that may be expected in the later years. As I said earlier, the word "mushy" is the best one that I can think of to describe the short-range outlook.

Without doubt, the brightest spot in the 1961 outlook is the construction industry. Construction is by far the Nation's largest fabricating industry. In the past three recessions, it has been instrumental in reversing the decline. It appears that the construction industry will again play that role in 1961, but with some significant differences from earlier recessions. I have been asked to comment in some detail on the prospects for construction.

Recent trends in construction: Each year from 1947 on, construction contracts[1] have reached a new alltime high in dollar volume. It was generally expected that 1960 would produce the first postwar decline, but a rather surprising upsurge in November and December pushed 1960 a tiny fraction ahead of the previous record set in 1959.

A substantial portion of the steady rise in contracts during the postwar period has been due to cost increases. Physical volume has not gone up as steeply or as steadily. And, of course, the individual categories of construction have all had their ups and downs. Nonetheless, it is a remarkable fact that despite three recessions, dollar volume of contracts has risen every year since 1945, and has been at a new record level every year from 1947 on.

The record total in 1960 was achieved despite a very poor showing by residential building, the largest category.

Contracts for residential buildings of all types fell off 12 percent in 1960 from the 1959 level, in dollars; the number of dwelling units represented by the contracts was down by 15 percent.

Within the housing category, however, there was one significant change: dwelling units in apartment buildings actually increased over 1959, by 6 percent. The result was that apartments accounted for almost 21 percent of all dwelling units in 1960, as compared with 17 percent in 1959.

Nonresidential building as a whole had a good year in 1960, with most categories reporting gains. Commercial building, the largest nonresidential category, was up 7 percent for the year. However, the picture here is, from the economic point of view, not quite as good as it appears, since the gain was produced entirely by office building contracts, with stores and other types of commercial buildings down. In other words, business was cutting back its plans for typical commercial building; while office buildings, where there may be some danger of temporary oversupply, continue to increase.

Contracts for schools made an excellent showing in 1960, setting a new record of slightly over $3 billion, some 13 percent ahead of 1959.

Industrial buildings were also up in 1960, 12 percent ahead of 1959. While this was an improvement, it still did not bring the figure back up to records set in earlier years.

The most substantial contract gains in 1960 were in heavy engineering. Highway contracts reached $4,272 million, a gain of about three-quarters of a billion, or 21 percent, over 1959. The 1960 figure was still well below the peak reached in 1958, however.

Two significant features of the 1960 contracts should be noted. First, the dollar gain was largely accounted for by highways and schools, which are largely Government-owned; while the principal decline was in housing, primarily private ownership. As a result, Government-owned projects accounted for 35 percent of all contracts in 1960, as compared with 31 percent in 1959. Moreover, the trend was upward during the year, with Government ownership reaching 45 percent in December.

[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.

Second, contracts showed great strength in the last 2 months of the year. In December, the Dodge index, seasonally adjusted, reached 302 (1947–49 equals 100), the highest point in history. Government-owned projects, including highways and schools, were largely responsible for this increase, but stores, hotels, industrial buildings and electric utilities were also running strong at the end of the year.

Construction in 1961: Since contracts have recently been at record levels, and since work will be performed on these projects for months and even years in the future, a high rate of construction activity is assured for at least the short-range future. However, not all categories of construction will benefit equally.

The contracts give a good preview of what is to come in construction put in place. It is more difficult to forecast future trends in the contracts themselves. We expect that contracts in 1961 will run about 2 percent ahead of 1960. The table below indicates our estimates of 1961 contracts by major categories.

We think that the dollar volume of housing contracts in 1961 will rise about 3 percent. In terms of the new Census Bureau series, we expect nonfarm housing starts in 1961 to total 1,325,000, up about 5 percent from the 1960 level.

Declines in business spending for new plant (commercial and industrial building) will be the principal factor in an expected drop of 2 percent in dollar volume of nonresidential building. Most nonresidential categories will remain strong, however.

The heavy engineering category, sparked particularly by highways, is expected to rise by about 5 percent in 1961, in dollar volume of contracts.

In terms of ownership, we expect that public projects will be up about 6 percent, while private projects will decline very slightly.

Housing in 1961: Housing is the largest category of construction. It is also the most interesting to those engaged in providing it, as well as to many policymakers. And it is problematical.

During the postwar period, housing has tended to behave in a contracyclical manner. That is, it has done well in recessions, and has often fallen off in times of boom. The net effect, while not always satisfactory to those in the industry, has probably been salutary for the economy as a whole.

However, this contracyclical behavior can hardly be considered normal, and the question must be raised as to whether, and if so when, housing is going to get back into phase with the general economy.

In the postwar period, housing has varied inversely with the general interest rate level. Since interest rates are ordinarily in phase with business activity, this has meant that housing has been out of phase, rising as business activity and general interest rates fall, and vice versa.

This behavior has been the result of a particular situation; namely, the fact that large Government-insured programs, with fixed and relatively low interest rates, have been a major element in new housing. Conventionally financed housing has shown no noteworthy contracyclical behavior; the roller coaster in housing has come entirely in the Government-insured sectors.

How is it possible that more houses have been built and sold in recessions, with incomes falling and unemployment rising? The answer lies in huge backlogs of unsatisfied housing demand, resulting from

16 years of underbuilding during the depression and World War II. In times of tight money, the FHA and VA doors were closed to much of this demand. As money eased, these doors were opened, and enough people were ready, willing, and able to buy houses to provide an increase in starts despite the recessions.

There is some evidence that the situation is changing. While many millions of people still live in substandard housing, nonetheless the Nation is far better housed than it has been at any time in the recent past. Increasing vacancy rates are evidence that demand is not as intense as it has been.

This poses serious questions for Government policymakers as well as for homebuilders. Will easier money and Government stimulation of housing programs have the impact in 1961 that they have had in other recessions? Or will these measures simply amount to "pushing a piece of string?"

It is our belief that while the contracyclical movement of housing is weakening, it is not entirely defunct. Hence our estimate that 1961 will see some modest gain in housing starts.

In this connection, I was somewhat surprised at the recent lowering of FHA maximum rates. It may be that through a rather complicated chain of reactions, there will be some benefit to housing. However, in the simplest terms, it is difficult to see how FHA rates, already at a competitive disadvantage in the money markets at 5¾ percent, will be made any more competitive at 5½ percent.

Demand pressure for housing will remain high, even if it is not quite as intense as in the past 15 years. Population growth and replacement needs indicate a basic annual demand for at least 1,300,000 new units a year during the early 1960's, and a higher level in the later 1960's.

But for the next several years, the growth in our adult population will be rapid among young adults and the elderly. The middle age groups, which include the typical home buyers, will remain almost unchanged. There will therefore be more demand for smaller, less expensive housing units to meet the needs and financial abilities of the young married couples and older persons.

This demand will probably be directed toward rental units, through necessity if not choice. However, if homebuilders are able to provide smaller, less expensive units they may well be able to tap part of this growing market.

One persistent problem in housing is cost. The prices of building materials and building labor have gone up more rapidly than other costs. In addition, prices of available land within reasonable commuting distance of employment centers have risen very sharply, and the cost of facilities has also risen. All these things have tended to put housing at an increasing competitive disadvantage with respect to other types of consumer spending.

The problems of mass transportation are directly connected to the future of housing. If existing commutation continues to deteriorate, while new developments spring up without sufficient transportation facilities, suitable housing land will be at even more of a premium, and the single-family home will be at a further disadvantage as compared to smaller rental-type units located close to central cities. As our population grows, it is apparent that a well-balanced and adequate housing supply is going to become more and more dependent on adequate mass transportation. This is an area in need of urgent consideration by all branches of government.

The construction industry itself can and undoubtedly will take steps to design and produce units suited to the demand. The important thing for the industry is the realization that the postwar sellers' market in housing is over. From here on out, buyers will take only those units they like, in locations they want, and with financing that suits them. Government agencies, in their efforts to stimulate housing activity, would do well to keep this fact of life in mind as they develop their policies. What worked well under the peculiar circumstances of the postwar period may not work so well today. The postwar period, even for housing, is over.

Consumer spending: Consumer expenditures both in real and current dollar terms moved up to a new high in the final quarter of last year after showing some signs of hesitation in the July through September quarter. On a seasonally adjusted annual rate basis, the fourth quarter total was $332 billion. As a result, total personal consumption expenditures for the year 1960 rose to an estimated $328 billion or 5 percent above the previous record set in 1959. According to the U.S. Department of Commerce, the upward trend of personal consumption expenditures accounted for about 75 percent of the total rise in GNP last year.

All during the postwar period, the American consumer has played a major role either in sending the economy to new high levels during periods of prosperity or in preventing any of our recessions from getting far out of hand by maintaining his rate of spending despite somewhat unfavorable economic conditions. While current indications are that the consumer is not particularly exuberant, nevertheless retail demand has held up very well during the past 6 months. Although sales did fall off somewhat in November and December on a seasonally adjusted basis, they were still well ahead of year-earlier levels and, in addition, the extraordinary weather conditions so far this winter have certainly played some part in the sales letdown.

What about the year ahead? Again let me turn for a moment to our economists' survey. The median expectation of the 327 economists shows a mild but steady rise in consumer expenditures through 1961. A fairly large number, however, feel that a small drop in expenditures may occur in the first half of this year but that the second half will see a rising trend once again.

The economists, in general, feel that durable goods expenditures will show some weakness this year as a result of the recession plus the fact that many postwar needs have now been satisfied. However, expenditures for nondurable goods and services should take up the slack and send total consumer expenditures upward with the year 1961 as a whole rising about 2 percent over the 1960 level.

The upward trend in nondurable goods expenditures and spending for services reflects the fact that many of these items are relatively fixed commitments. As I stated to this committee a year ago, a fairly large proportion of consumer spending is not really discretionary. Food, for example, accounts for nearly half of nondurable goods spending and in the services sector, the largest housing expenditure is a purely theoretical concept—the imputed rental value of owner-occupied dwellings.

Few consumers have ever heard of this concept and of course no actual money payment is ever made. Nevertheless, this one item accounts for more than 20 percent of all consumer expenditures for services.

It seems reasonable to expect, therefore, that the consumer will again provide a large measure of support to the economy during the year ahead. While no sharp upsurge is anticipated in any one particular sector, total spending at the retail level should edge up gradually, at least after midyear, and the figures for the year as a whole should show modest improvement over 1960.

Summary: The economy has been drifting downward for some months. There is reason to believe that it will begin to drift upward again later this year. However, there seems to be little reason to expect anything in the nature of a runaway boom during the recovery period. In past recessions, the construction industry has played the role of the knight charging to the rescue of the fair maiden, and there is every indication that it will do so again in 1961. There will, however, be some significant differences in the way the rescue is effected. In particular, Government-owned projects will play a larger part, and housing a somewhat lesser role, in reversing this recession.

(Statement supplied by Dr. Smith follows:)

Estimated dollar volume of construction contracts (48 States)

Classification	Year 1960	Year 1961 estimate	Percentage change [1]
	Millions	*Millions*	
Nonresidential	$12,240	$11,995	−2
Residential	15,105	15,560	+3
Total building	27,345	27,555	+1
Public works and utilities	8,973	9,420	+5
Total construction	36,318	36,975	+2
Private ownership	23,731	23,635	0
Public ownership	12,587	13,340	+6
Dodge Index (1947–49=100)	266	272	+2

[1] Percentages rounded to nearest whole number.

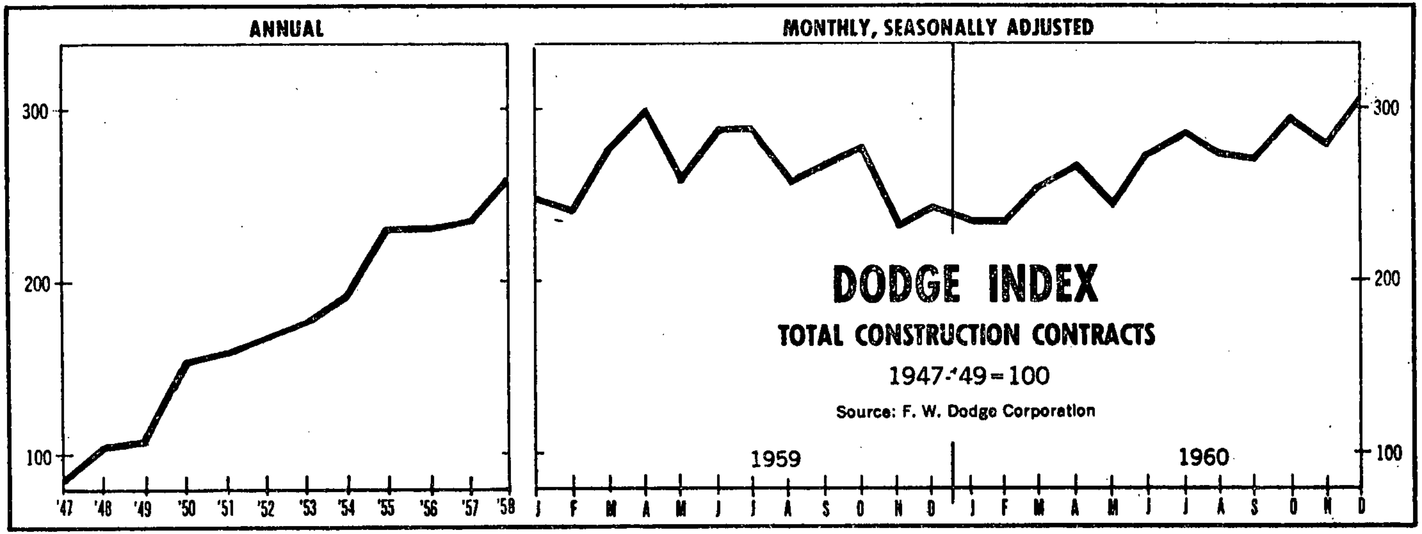
Source: Estimate by economics staff, F. W. Dodge Corp., revised from earlier estimates on the basis of final figures for 1960.

Estimated physical volume of building contracts (48 States)

Building classification	Year 1960	Year 1961 estimate	Percentage change [1]
	Millions of square feet	*Millions of square feet*	
Commercial	283	272	−4
Manufacturing	178	160	−10
Educational and science	196	196	0
Hospitals and institutions	36	37	+3
Public	33	34	+3
Religious	53	54	+2
Social and recreational	44	42	−5
Miscellaneous nonresidential	31	32	+3
Total nonresidential	854	827	−3
Residential	1,300	1,333	+3
Total building	2,154	2,160	0
New nonfarm dwelling unit starts (Census Bureau basis)	1,259,200	1,325,000	+5

[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 1960.


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 '58
1959
1960
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. Thank you.

Our next witness on the outlook for labor force and employment is Mr. Ewan Clague, Commissioner of the Bureau of Labor Statistics, U.S. Department of Labor.

STATEMENT OF EWAN CLAGUE, COMMISSIONER, BUREAU OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

OUTLOOK FOR LABOR FORCE AND EMPLOYMENT

Mr. CLAGUE. Thank you, Mr. Chairman.

I have a long statement here which I should like to submit for the record. I shall summarize in 10 minutes the key points that I am trying to make.

The CHAIRMAN. Without objection, it is so ordered.

Mr. CLAGUE. With respect to employment and unemployment there are four different factors that have a bearing: the seasonal, the cyclical, the long-term trend, and the structural or frictional.

In my report, I point out that there were 5.4 million unemployed in January, which was 900,000 more than in December. That rise was approximately seasonal.

In other words, we should expect high unemployment in the winter months of January and February.

I go on, then, to point out that if we had a purely seasonal shift in unemployment, if there were no other changes except seasonal during the rest of this year, unemployment would fall to 4.8 million in April, 4.6 in May, it would rise to 5.3 million in June when the students come out, it would fall to a low point of 3.8 million in October, and it would end up the year at 4.5 million in December, as it did last year.

That is the normal seasonal pattern.

Now, turn to my charts. Chart 1 shows the rate of unemployment in three recessions, seasonally adjusted.

This rate takes out that seasonal swing I was talking about and concentrates on the ups and downs of business. The top solid line (1960–61) indicates that we had our relative low point in unemployment in April and May, about 5 percent of the labor force last spring.

Then it rose irregularly higher until it was 6.8 percent in December. It fell to 6.6 percent in January.

Those figures are coming out this morning at the Department of Labor.

For the prospect for 1961, I would like to turn to the next chart, which shows the way unemployment lags with respect to the changes in business. The gross national product represents the total volume of production in the economy.

Against that we have plotted unemployment and employment. In the recession of 1958 the bottom of the gross national product was reached in the first quarter, followed by a sharp upturn in the second quarter, a still sharper upturn in the third quarter, and on up through the end of the year.

The bottom of the employment trend was reached in the second and third quarters of the year, and the peak of unemployment was also reached in the third quarter—both sets of data being seasonally adjusted.

In other words, unemployment continued upward for two quarters after business had already started up.

Now, if you mentally picture the extension of the chart to 1961, you might find this same phenomenon developing. If we hit bottom in the first or second quarter of this year, you might expect one quarter or two quarters delay in any rise in employment.

Likewise, we would expect a rise in unemployment rather than a fall the next quarter or two afterward. So unemployment is likely to be comparatively severe during 1961.

Turn to the next chart, in which I open up the third factor I mentioned, namely, long-range trends.

I would like to call attention to two trends: One is the normal growth of the labor force.

Note first the period 1950–55, when we projected what we in the Bureau of Labor Statistics thought the labor force would be, and then compared this projection with the actual figures for each year.

For 1955 to 1960, we did the same thing.

We were about 600,000 too high in 1960 in our projection. But nearly half that gap of 600,000 consisted of men beyond the age of 65.

From this we conclude that they are the ones who have voluntarily or involuntarily retired on old-age and survivors insurance and have left the labor market.

We estimate, conservatively we think, about 1 million gain in the labor force during 1961.

So that is the number of new jobs we shall need to take care of the growth in the labor force.

Then the next two charts are pointed toward a second factor, namely the great industrial shift which has occurred during the 1950's. The first chart shows the period 1947–53. At that time there was a spectacular growth in durable goods manufacturing employment, which rose very sharply in 1950, 1951, 1952, and 1953. These are the heavy metal industries which had their wartime prosperity and their expansion at that time.

I have also plotted on this chart the declining agricultural employment. Employment in agriculture declined from about 8 million in 1947 to less than 7 million in 1953. We lost a million jobs there.

The next chart, 4–B, brings out the same point. Agriculture has continued its decline. It employed somewhat less than 7 million in 1955 on the average, but it has now dropped down to about 5¾ million in 1960.

We have lost another million jobs in agriculture in the last 5 years.

In the period since World War II peak employment in durable goods manufacturing was about 10 million, reached in 1953. Employment in the boom of 1956–57 did not reach that previous peak; while in 1959–60 employment was still lower. At the present time it is less than 9 million. We have lost a million workers there.

So some of the unemployment we are now experiencing in different parts of the country consists of the workers who were brought into these heavy goods industries during those previous booms.

I might call attention to the two most rapidly growing employments. Service, finance, insurance, and real estate have been growing steadily and employment in that group of industries has risen about 1½ million since 1953.

The other is State and local government employment which has increased about 50 percent during the past 7 years.

It has come up from about 4¼ million in 1953 to about 6½ million today.

I would like now to summarize my fourth category—the structural factors. I call your attention to the geographic immobility of the labor force. We are experiencing great changes in industry.

The problem is that labor does not adjust rapidly to these changes.

Next, there is the handicap of occupational immobility. The workers have certain skills, but industry needs different skills.

So we have trouble getting unemployed workers into industries where they can work effectively.

Then there is the question of time. It takes time to bring about these readjustments and it is a continuing problem of trying to match the shifts in industry and the readjustment of the workers.

Next, just a brief statement on the reemployment outlook for 1961.

First, if there is a 1 million growth in the labor force that will take, say, something like $8 or $10 billion increase in the gross national product to employ that million.

Then productivity must be taken into account. I have made a conservative estimate of about 2 percent rise in productivity in a year. That would mean about another $10 billion of product to take care of that.

Finally, we must take account of the cut in working hours. There has been a sharp decline in the actual hours of work of those who are employed.

As business recovery takes place, the first thing employers do is to put their existing force on full time. I have estimated another $5 billion of product to take care of this factor.

So, in conclusion, I arrive at the point that, with present price levels, you would need a gross national product in the last quarter of 1961 of about $525 billion in order to reduce unemployment to 4½ million, which it was last December.

Now, just a word about prices. Consumer prices have risen about 1½ percent per year for the last several years.

I would guess for 1961 about the same rate of increase.

In that case we must allow for another $7 or $8 billion of gross national product in order to include such a price rise. So, if we have that amount of price increase, the gross national product would need to be between $530 and $535 billion in order to balance out at the unemployment rate of last autumn.

On wages I will simply say that wages are the safest factor to predict. They will certainly go up.

I call your attention to four wage factors which will be operating during the year.

One is the key contracts that have just been negotiated this last year in steel, railroads, and electrical equipment and the effect that they might have.

Secondly, there is the automatic escalation by the consumer price index. There are about 2½ to 2¾ million workers who have wage escalation on that basis.

If the consumer price index goes up only 1½ percent, this will not be a very heavy factor in wage increases in 1961.

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Third, much more important are the deferred wage increases which are scheduled to take effect in 1961.

In my prepared statement (p. 30) I present a table on this point. For the last several years deferred wage increases have averaged 7 cents, 6 cents, 6 cents, 6 cents, 7 cents. Notice that the negotiated increases each year always exceed those amounts by 1 or 2 cents.

By that test you may expect an average increase of 8 or 9 cents in the negotiations of 1961, if this pattern works out.

Finally, I would like to call attention to nonwage benefits. The pattern of collective bargaining is changing. There is more attention now on unemployment and on the methods of taking care of unemployment. At the same time employers are paying more attention to the question of productivity and efficiency in production.

There have been several automation fund operations set up this year, and I would hazard a guess that collective bargaining in 1961 will be paying more attention to that factor.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Clague.

(The formal statement of Mr. Clague follows:)

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I. EMPLOYMENT AND UNEMPLOYMENT

An ideal appraisal of the current employment situation should take account of (1) seasonal, (2) cyclical, (3) long-term trend, and (4) structural or frictional factors. However, statistical methods are not sufficiently refined to measure the relative importance of all of these factors at any one time. It is possible, however, to analyze briefly the significance of each of these in the employment-unemployment picture of 1960–61.

Seasonal

There are marked seasonal swings in the U.S. economy as a whole as well as in a number of sectors and industries. Total employment falls to its low point of the year in January or February and reaches its peak in July or August. There are usually some 4 million more workers employed in midsummer than in midwinter. Agriculture, construction, and other seasonal industries contribute to this marked swing in employment.

Unemployment works in reverse, although it is not exactly the opposite. The yearly peak of unemployment usually occurs in January or February, but there is frequently a secondary peak in June when students enter the labor force seeking summer work. The low point in unemployment occurs in October, after the summer workers have returned to school and when industrial production is at a high point.

So the fact that there were 5.4 million unemployed in January, and that this was about 900,000 more than in December, is due in part to seasonal factors. The Bureau of Labor Statistics has prepared (as we do each year) a new set of seasonal adjustment factors for unemployment (table 1). On the basis of these, I can say that if unemployment would change during the coming year strictly in accordance with seasonal expectations—and for no other reason—the unemployed would fall to about 4.8 million in April, 4.6 million in May, rise to about 5.3 million in June (students), fall to a low point of 3.8 million in October, and end the year 1961 with 4.5 million in December.

Cyclical

Of course, neither employment nor unemployment will fluctuate during 1961 strictly in accordance with seasonal factors. It will also be influenced by the longer swings in business conditions, by recession and recovery—the so-called business cycle. This factor is pointed up by chart 1, which presents the seasonally adjusted unemployment rate, that is, the percentage of the unemployed in the total civilian labor force after removing the effect of seasonal variations.

This shows that the low point of unemployment was reached in May (5.1

percent), after which the rate climbed more or less steadily to December (6.8 percent). One difficulty in interpreting the unemployment situation for the general public is that while the seasonally adjusted unemployment rate was rising, the actual number of unemployed was falling—from 4.4 million in June to 3.6 million in October. The seasonal and the cyclical were working in opposite directions, and for those months the seasonal was much the stronger. Some long-term factors were also operating, as I shall show later.

Looking forward into 1961, I want to emphasize one other point concerning the relationship of employment and unemployment to the business cycle. This is shown in chart 2, which compares the swings in gross national product with (*a*) the level of total employment and (*b*) the unemployment rate—all seasonally adjusted. The data are shown as quarterly averages in order to smooth out the monthly fluctuations. The point is that reemployment lags in business recovery, and unemployment may very well increase for awhile after production picks up. So even when business reaches bottom and starts to turn upward, unemployment could go on increasing (cyclically) for another quarter.

Long-term trends

The committee is familiar with the work we have been doing in the Department of Labor in making future projections of the labor force. Deputy Assistant Secretary Wolfbein presented much of this information at a hearing before your committee last December. All that I plan to do here today is discuss the current situation in the light of these projections and to look into 1961.

The labor force grows every year because the number of new entrants is substantially larger than the number who die or retire. During the 1950's the annual growth was about three-quarters of a million. But as we enter the 1960's the growth is stepping up. Larger numbers of young people are reaching working age.

This growth is not exactly steady; there are fluctuations from year to year. Chart 3 shows two projections made by the Bureau of Labor Statistics (1951–55 and 1956–60), along with the actual annual experience. Note that the actual tends to fluctuate around the trend, sometimes running ahead and sometimes falling behind. In 1955 our estimate hit the nail on the head, but in 1960 it was somewhat too high. Nevertheless, the increase in 1960 over 1959 was about 900,000, after allowing for Alaska and Hawaii. The growth was about equal to the projected amount but the level was still below trend by about 600,000 as a result of the several previous years of dampened increase (table 2).

About half of the 600,000 deviation was concentrated among men 65 years of age and over. The labor force participation rate in this group has been declining for a long time, but in the last several years the drop has been greater than the pace suggested by past trends. In part, this reflects greater voluntary retirement but it may also indicate the effect of the loose labor market situation which does not encourage the continued employment of these older men or their reemployment once they have lost their jobs. Another group whose numbers in the labor force are below trend, but to a smaller degree, is teenage boys.

For all women of working age, the number in the labor force was at the level expected on the basis of long-range trends. However, there were deviations in both directions among the several age groups. In ages 18 to 24 a greater number were in the labor force than was anticipated. There is no indication from available data on marriages or births that there has been any change in the pattern of early marriage and starting of families which might account for the greater work activity in these ages. In addition there were more women 45 to 54 years of age in the labor force than projected for 1960. The increase in the rate of labor force participation for this age group has been among the most persistent and dramatic developments in labor force changes in recent years.

Offsetting these two surpluses were somewhat smaller than expected numbers among women 25 to 34. Their labor force participation rate has increased in recent years but not to the extent anticipated. There are as yet no discernible changes in the pattern of family formation which underlies the projection of increasing labor force participation as more women in these ages complete their families and become available for work.

As the number of young workers begins to grow in the sixties, there will be some impact on the unemployment levels; however, the effect was small in 1960. During the summer there were about the same number of teenagers unemployed as in 1959 although their numbers in the labor force were growing.

On the basis of long-term trends in labor force participation rates by age and sex, we could anticipate another rise of 1.2 million in the labor force in 1961. About 425,000 of these will be teenagers and another 150,000 workers 20 to 24 years; women will account for about three-fifths of the remaining 600,000. However, slack business conditions may depress the rate of labor force growth—some marginal workers, such as students and homemakers, do not enter the labor market; while others, such as older men and women, go into retirement. On a conservative estimate, the labor force should grow by 1 million workers during 1961.

Another long-term factor is the great industrial and occupational shift which is taking place in our economy. This is illustrated in part by charts 4a and 4b, which show employment in eight major nonfarm industry groups from 1947 to 1953, and then from 1953 through 1960. To show the size of the problems which our growing industries face in absorbing workers from other industries, I have also placed on this chart the trend in farm employment.

My interpretation of this chart is as follows: The industrialization of our economy has been so successful that we need proportionally fewer workers to turn out larger stocks of goods for more people. At the same time, our society has developed to the point that we demand and require more and more services, both public and private. This is the underlying trend.

Of course, there are other factors, and these show up in the chart. World War II created many shortages of consumer goods—in fact, almost all such goods. When the war ended and consumer demand dominated the economy, the industries which could respond most quickly (because they needed no prolonged reconversion) were the soft goods industries; by 1949, these industries had begun to catch up with demand. Although hard-goods industries were affected by the recession of 1949, there was still a strong unsatisfied demand for their goods; the recession was in fact moderated by the continued rising demand for automobiles and new homes.

The outbreak in Korea interrupted the shift of the heavy industries to consumer production. New shortages were created by that war, and vistas of greater shortages as our population expanded. So the sharp boom of 1955–57 was a heavy industry boom. These industries were busy supplying producers' goods for businessmen to meet future needs in addition to consumers' goods for the population. The recession of 1958 was largely due to declines in the heavy industries.

The business recovery of 1959–60 was a halting one. Part of the pickup was due to anticipation of a steel strike; but following the strike signs of slack started to appear in manufacturing industries. These industries had developed more capacity than they needed to satisfy current consumer demand; or looked at another way, consumer demand had not kept up with their ability to produce.

Note that it is the goods-producing industries which have been declining in employment in recent years. Durable goods manufacturing is one example. Each new high point after recovery from a recession has been lower than the last. In 1955 and 1956, when we had generally high employment, durable goods had fewer jobs than in 1953, and in 1953 of course this sector had fewer jobs than during World War II. Now we haven't returned to the job levels we had between 1955 and 1957. Peak employment after Korea occurred in 1955 for the auto industry and the rubber tire industry; between 1955–57 for steel; in 1957 for fabricated metals and machinery.

Some goods-producing industries have been heading down in their employment almost without interruption. Mining has continued its long-term decline—employment in this industry was lower in 1960 than at any time in the 41 years for which the Bureau of Labor Statistics has kept employment records. Agricultural employment has also persisted in its long-term downward trend, and has fallen by 2.5 million, or 30 percent, since 1947.

On the other hand, note in the chart the persistent gains in employment in State and local governments (not Federal)—this growth was in our school systems; in trade, in service, and in the real estate, insurance, and finance group.

These employment increases reflect the pressure of the new consumer demands for schools, hospitals, streets, sewers, waterworks, roads, parks, and other facilities which are largely public or of a service character.

We have also had changes in the kinds of jobs workers have. There have been large increases among white-collar workers. The complexity of our economy has required more education and training; we have needed more engineers, scientists, and other professional people, and more clerks to handle the paperwork. The demand for laborers and semiskilled workers has not shown anything like the increase in white-collar workers.

The Nation's labor force reflects these industrial and occupational shifts. Shortages and scarcities of labor are found in professional and technical occupations and in crafts requiring specialized training. Unemployment is most acute among blue-collar workers in goods-producing industries during recessions, and often remains a standing problem among these workers even in periods of generally high employment.

Structural factors

The employment problem is still further complicated by a series of factors which have been variously termed "structural, frictional, or institutional." The central fact about a progressive, expanding economy is change—rapid, far-reaching, and often unforeseen change—new materials, new processes, new products, new industries, new demands. The Nation's labor force has to adapt itself to these changes. Farmworkers released from agriculture have to find jobs in factories or in transportation or construction; blue-collar workers must acquire new skills; workers in declining industries must find jobs in expanding ones.

But these adaptations are not always easy to make. There are many frictions, both in industry and among the labor force, which impede the adjustment. I shall list some of the more important of these.

Geographic immobility.—Industries in a community close down or move away, but the workers remain unemployed. In a community with diversified industries, new jobs may be opening up and the unemployed can find work right at home. But one-industry towns, or even large cities dominated by a few major industries, can become distressed areas with high unemployment.

Why don't the workers move? There are many reasons—family ties, home-ownership, educational facilities, pension and benefit rights, inertia, lack of assurance of opportunities elsewhere. And there is always the hope that something will open up in the hometown.

But how did we get such spectacular geographic labor mobility during wartime? That was different. Jobs were available everywhere, wages were substantially higher in the war industries, employers gave firm job assurances, transportation costs were paid, homes could be sold readily (but there were often housing problems in the new communities). In the more evenly balanced economy of peacetime, these conditions do not exist.

Occupational immobility.—There may be job openings in the hometown, or even firm openings somewhere else, but the worker hasn't the qualifications to fit the requirements. It is easy to tick off the familiar list—lack of education, lack of skill, lack of training opportunities, age, color, sex, language, other handicaps.

Of course, there are many jobs the unemployed worker could fill with his existing qualifications. But they may be already filled. Until some of the workers holding those jobs obtain advancement, or retire from the labor market, those jobs won't be open.

Time.—Ranging all through the above difficulties is the element of time—it takes time to bring about the adjustments of workers to jobs. This is the basic justification for unemployment insurance—a holding operation until the unemployed can find a job which fits his qualifications. This is the logic for apprenticeship, for training, for vocational guidance, for rehabilitation, for retraining. And it is the reason that the Department of Labor has put so much emphasis on the occupational outlook for the 1960's—the projections of the labor supply, the Occupational Outlook Handbook, the stress on education to start young workers on the road to job opportunities.

The road to solution of these problems is not to slow down the rate of change, but to speed up and facilitate the necessary readjustments.

Impact of current recession

Although workers in the durable goods industries were the first to feel the impact of the current recession, its effect appears in all sectors of the labor force. A comparison of 1960 data with those for 1957, the last year in which unemployment averaged under 5 percent, shows where we are in trouble. In 1957, the unemployed were jobless largely because of seasonal and structural factors; in 1960, these forces were augmented by reducitons in demand which have had a fairly pervasive widespread effect.

The unemployed averaged 3,931,000 in 1960, 1 million more than in 1957. In both years, slightly over one-third were young workers under 25. Except for a slight shift in the direction of youth, the age-sex composition was the same at both dates (table 3). Unemployment rates have increased in almost every age group (table 4).

In every major industry group, unemployment rates were significantly higher in 1960 than in 1957 (table 5). The year-long job cutbacks in durable goods industries in 1960 were not the only source of higher average unemployment rates in 1960 than 3 years ago. Even in generally expanding service-producing industries like trade, service, and public administration, the 1960 rates were higher.

Workers in all occupational groups (except farmers) had higher unemployment rates in 1960 (table 6). Nonfarm laborers, operatives, and craftsmen were particularly hard hit. White-collar workers in both years had the lowest unemployment rates but they too were worse off in 1960 than in 1957.

Long-term unemployment was considerably more serious in 1960 than in 1957 (table 7). Workers unemployed for 15 weeks or more made up 19 percent of the total in 1957 and 24 percent in 1960; those out of work at least half a year rose from 8 percent to 11.5 percent of all unemployed. The short-term unemployed were more numerous in 1960 than in 1957, but they were a smaller part of the total—46 percent against 51 percent.

The characteristics of the long-term unemployed were not much changed (table 8). They were somewhat younger in 1960 than in 1957 and less concentrated in manufacturing industries. There is some evidence of an increasing proportion of white-collar workers, on the one hand, and nonfarm laborers, on the other.

Unemployment after recovery

On the basis of these data for 1957 and of studies we made for this committee in 1959, it is possible to make some rough guesses as to what would be the nature of the unemployment problem that remains if we were to succeed in increasing demand sufficiently to reduce the unemployment rate to the levels which prevailed in the relatively prosperous years of 1956–57. The rate of that period, 4¼ percent, would be expected to increase by 0.1 or 0.2 percentage points chiefly because of the increasing proportion of young workers in the labor force, whose unemployment rates are typically the highest. Thus, applying a 4.4 percent rate to an estimated 71.8 million in the civilian labor force in 1961 would give an estimated unemployment of 3.2 million, if full recovery were to come this year.

These 3.2 million, it is estimated, might be made up of roughly 2 million adults (workers 25 and over) and 1.2 million young workers under 25. About 600,000 of the unemployed would be classified as long-term (jobless for 15 weeks or more), almost all of them adults. These estimates are summarized in the following table:

	January 1961 [1]	High employment assumption
Total unemployment	5,385,000	3,200,000
Unemployment rate	6.6	4.4
Adult workers (25 years and over)	3,795,000	2,000,000
Long-term	961,000	500,000
Other	2,835,000	1,500,000
Young workers (14 to 24 years)	1,590,000	1,200,000
Long-term	377,000	100,000
Other	1,213,000	1,100,000

[1] Only the unemployment rate in this column is seasonally adjusted; the unadjusted rate was 7.7 percent.

We thus would be faced with two major problems—persistent unemployment and unemployment among youth.

The special measures to aid depressed areas that are being considered by the Congress would be an important line of attack on long-term unemployment. Our studies suggest that about one-half of the unemployed in the chronically depressed areas were long-term unemployed, even during periods when the national economy was operating at fairly high levels. With special measures to aid depressed areas, effective enough to reduce the rate of unemployment and long-term unemployment in these areas to national averages, unemployment in depressed areas might fall to half the estimated late-1960 level of 500,000, with about two-thirds of the reduction among the long-term unemployed. As a result, long-term unemployment nationally would be reduced to about 15 percent of the remaining jobless total, or to something less than half a million.

These remaining long-term unemployed would present a variety of problems. Some are jobless because of basic structural changes in the economy, arising from technological innovation or geographic shifts in industry. Some don't have the skills that are in demand and are unable to acquire them through lack of opportunity or capacity. However, even the industries and occupations that are expanding, such as trade and services, contribute to the long-term unemployed; as many as one in four of the long-term unemployed in 1957 had last worked in these industries.

Much has been written about the characteristics of the long-term unemployed and I shall not repeat the description here. Clearly, retraining might return some to jobs, but for others—older workers, Negroes—the inability to return to work may reflect discriminatory hiring practices that cannot be changed rapidly. For still others, the difficulties are personal—ill health, lack of education, and the like—which cannot be solved by an employment program.

The problem of the unemployed young worker might be easier to solve. Their rate of unemployment is always high, but a resumption of business activity would provide substantial benefits. Under full employment conditions, the number of unemployed under 25 years was about two-fifths lower than it was in January 1961 (seasonally adjusted). Nevertheless, even in 1957, young workers constituted 34 percent of the total unemployed.

About 15 to 20 percent of youth unemployment is accounted for by students seeking part-time jobs, perhaps to help them stay in school, perhaps for pocket money. A more serious problem is that of young workers who drop out of high school before graduation. These dropouts account for approximately 40 to 45 percent of the unemployment in this age group. In the 1960's, when a much higher number of young people will be competing for jobs, the employment problem of the dropouts will be greatly magnified.

Another factor accounting for the high unemployment rate of youngsters is their tendency to shift from job to job, lacking sufficient guidance at the beginning of their careers or sufficient information; without seniority, they also lose jobs more readily.

An attack on the unemployment problems of youth must be chiefly concentrated on training, guidance, and placement programs.

The outlook

Employment totals are, of course, determined largely by economic activity. But it is important to recognize that labor force growth, productivity trends, and the length of the workweek are also important determinants of the level of unemployment.

As I have indicated earlier, the rise in the labor force in 1961, in the light of presently foreseeable demand, could be expected to be in the neighborhood of a million. This growth would call for an increase of some $8 to $10 billion in gross national product between the end of 1960 and the end of 1961.

Similarly, productivity gains are to be expected this year, although the exact rate of rise is difficult to predict. The actual changes in any one year will vary considerably, depending on many factors, particularly changes in volume of output, reflecting the different phases of the business cycle.

In general, we find that during a period of recession, when production declines, productivity gains are less than average. In the recovery period, the increase in output per man-hour is usually higher than average. This is what happened in the recovery year 1959, for example, when output per man-hour for the total private economy increased by more than 4 percent. As the increase in production slows down, after the initial recovery from recession, the rate of increase in output per man-hour also slackens. In 1960, when the increase in real product for the private economy was only 2.7 percent (compared to an increase of about 7 percent in 1959), the increase in output per man-hour was 2 percent.

Farm output per man-hour showed a gain of about 8 percent in 1960, due in large part to a substantial increase in farm production accompanied by some decline in farm employment. Therefore, the increase for the nonfarm economy was somewhat less than 2 percent, with some indication that most, if not all, of the gain was achieved in the early part of the year, before the decline in production which occurred in the second half of the year.

In line with past trends, it may be expected that increases in output per man-hour in 1961 will reflect in large part the course of the business cycle. If the cycle reaches a trough in the first half of 1961, followed by a gradual recovery, then output per man-hour may show little or no change in the early part of the year, followed by gains in productivity in the second half. It could well be, on this basis, that productivity would average some 2 percent more at yearend than a year earlier. This would be the equivalent of a rise of $10 billion in gross national product.

An additional factor to take into account, and more difficult to quantify, is the tendency of employers to cut hours in advance of lay-offs and to lengthen them before hiring. In January 1961, there were about 1.7 million full-time nonfarm workers whose hours had been cut below 35 a week for economic reasons. This was half a million more than a year earlier. Most of the increase in this type of underemployment was among factory workers, particularly operatives and craftsmen. There has been almost no reduction in hours reported among full-time white-collar and service workers.

Thus, as a result of these factors of labor force growth, productivity, and hours, it would be necessary for the gross national product to rise to as much as $525 billion, if unemployment in the last quarter of 1961 is to hold at the levels prevailing in the last quarter of 1960. This assumes no change in prices.

II. PRICES

The most significant development in prices during 1960 was a gradual weakening in the primary market prices of a varied group of industrial commodities; farm and food prices moved up, however, so that the Wholesale Price Index averaged about the same as a year earlier. In contrast, the Consumer Price Index rose, mostly because of increased food and service costs.

Wholesale prices

For the last 3 years, the overall Wholesale Price Index has fluctuated within a very narrow range of little more than 1 point, that is, from 118.9 to 120.0 (1947–49=100). However, the stability of the overall index has been the result of a balancing of significant diverse price movements for some of its components (chart 5). During 1960, for example, wholesale prices of industrial commodities moved irregularly downward at a moderate pace, while prices of many farm products and processed foods were irregularly higher. This was in contrast to the situation in 1959, when nonagricultural prices rose and farm products prices dropped.

The downtrend in industrial prices during 1960 was influenced by a complex of economic developments. These included lagging construction activity, a slump in demand for steel, cautiousness in inventory accumulation after the first quarter of the year, a levelling out in business spending for capital equipment and a lack of strength in consumer spending for durable goods.

Advancing farm product prices in 1960 marked a reversal of the 1959 downtrend. The rise primarily reflected adjustments in production to the relatively unfavorable market conditions prevailing early in the year. Under the influence of low hog prices the spring pig crop was curtailed, and the reduced supply of hogs raised prices later in the year. Low egg prices at the beginning of the year spurred reduction in laying flocks which led to lower supplies and higher prices of eggs in the second half of the year. Crop reductions caused by hurricane damage raised many fruit prices in the latter part of the year. Processed foods prices rose more than 4 percent over the year, reflecting higher costs.

Consumer prices

The Consumer Price Index in December was 1.6 percent higher than a year earlier—about the same as the rise in the 2 preceding years (chart 6). Considerable shifts occurred in the components, however. Food prices increased more than 3 percent over the year—an unusually large rise, in contrast to a decline in 1959; meats and eggs were the main factors in the increase during 1960. Fresh fruits averaged 5 percent higher than in 1959, largely as a result of unfavorable growing conditions and hurricane damage.

Nondurable commodities other than food rose nearly 1 percent, but considerably less than in 1959. The overall rise in services, excluding rent, was 2.6 percent, compared with 3.0 percent in 1959. Medical care service costs were up by about 4 percent—the largest increase in the service category. On the other hand, durable commodities dropped 2.6 percent, for the first decline since 1955, with automobile prices accounting for almost all of the drop. Household appliance prices also were moderately lower.

Outlook for 1961

During 1961, major price changes will hinge largely upon the pattern of demand; if demand rises only slowly, most price changes should be relatively moderate.

At the retail level, prices for services will probably continue to rise, influenced primarily, as they have been in the past, by higher costs of medical care and of home ownership and upkeep. Food prices could rise more than they usually do until their seasonal peak in late summer, but could fall off fairly sharply in the fall and winter; this is chiefly because of the trend in the price of meats, which are especially important in the consumer's market basket. On balance, food prices might possibly average somewhat lower than they were in December. Most nonfood commodities are not expected to change much, although prices for durable goods may strengthen after their marked decline in 1960.

At the primary market level, prices for farm products and processed foods are generally expected to be moving moderately downward by the end of the year, although this is a difficult field to forecast because of the influences of the weather. Industrial prices, on the other hand, may well be subject to some upward pressure later in the year, as the inventory liquidation is reversed and when construction increases.

III. WAGES

Developments in 1960

Preliminary estimates indicate that about 7 million workers (representing 85 percent of all workers employed under major collective bargaining contracts[1]) received wage-rate increases. Of this number, about 4.3 million were employed under contracts that were renegotiated during 1960, and most of the rest received deferred wage rate increases (frequently supplemented by cost-of-living increases).

The most common increases effective during the year—covering about 1.4 million, or 20 percent of the workers receiving increases—averaged 10 but less than 11 cents an hour. Next most frequent were raises averaging 9 but less than 10 and 6 but less than 7 cents, affecting 15 and 13 percent of the workers, respectively. Slightly more than one out of five workers received increases averaging 11 cents or more an hour.

New or liberalized fringe benefits were included in settlements affecting about 80 percent of the workers covered by major contracts negotiated during 1960, about the same proportion affected in previous years. The most frequent improvements were in the field of health and welfare benefits (including such items as hospitalization, life insurance, major medical plans, and surgical care); other frequently changed provisions included vacations, pensions, and holidays.

Despite wage-rate increases under collective bargaining the rise in hourly earnings for all factory production workers was held down during the year by the relatively greater decline in employment in industries paying higher than average wages than in other industries and by a decline in overtime work. Because of the decrease in overtime payments resulting from the shorter average workweek in 1960, gross hourly earnings rose 2.2 percent (5 cents) compared with a 2.7 percent increase (6 cents) in average hourly earnings, excluding overtime (table 9).

In spite of the rise in hourly earnings, average weekly earnings of factory workers, affected by shorter working hours combined with smaller overtime premium payments, actually declined by 2.8 percent over the year (from $92.16 to $89.55). Between December 1959 and December 1960 the decline in real weekly earnings—reflecting also the effect of a 1.6 percent rise in the Consumer Price Index—amounted to a net loss of 4.3 percent.

In nonmanufacturing, changes in gross average hourly earnings ranged from a decrease of 1.5 percent in bituminous coal mining, because of a substantial decline in number of hours worked, to an increase of about 6 percent in nonbuilding construction and 7 percent in telegraph communication (table 10).

Outlook for 1961

The wage picture for the coming year can be discussed in the light of four factors: (1) "Key" contracts negotiated in 1960; (2) the extent of wage increases based on consumer prices; (3) wage increases already scheduled to go into effect in 1961; and (4) the pattern of nonwage supplementary benefits.

[1] Data are limited to situations affecting 1,000 or more workers in all industries except the construction trades, service, finance, and Government.

Key contracts of 1960.—Among the contracts negotiated in 1960, two significant elements were common in the steel, railroad, and electrical equipment agreements—the timing of wage-rate increases and the cost-of-living escalator clauses. The steel agreements negotiated in January 1960 provided for only two wage-rate increases over the 30-month period, ending in the summer of 1962. The first increase was deferred until December of 1960,[2] and the second is to become effective in October 1961. In addition, the escalator clauses were modified to provide two reviews over the contract term (instead of one each 6 months), and to limit total future increases to 6 cents, with up to 3 cents of this amount permissible in December 1960. Part or all of these adjustments, however, could be used to offset the rise in the costs of the companies' insurance programs above a specified maximum. Although the Consumer Price Index had risen sufficiently to warrant a 3-cent increase on December 1, 1960, the advance in insurance costs offset this increase.

In the case of railroads, contract amendments negotiated in the summer of 1960 provided a 5-cent-an-hour raise on July 1, 1960, for the nonoperating employees and increases totaling 4 percent (2 percent effective in July and the balance in March 1961) for the operating personnel, before their agreements are subject to renewal in November 1961. Although it is true that wages may be discussed any time after this date, it does not seem likely that any wage increase will be forthcoming in the immediate future, bearing in mind the complicated and time-consuming procedures of the Railway Labor Act. The semiannual cost-of-living escalator clauses were eliminated from the contracts.

The 3-year contracts signed in the fourth quarter of 1960 in electrical equipment provided for only two general wage-rate increases—one effective in October, and the other not until 18 months later, in April 1962. These contracts will expire in the fall of 1963. The cost-of-living escalator clauses, which provided adjustments on a quarterly basis, were dropped from the new contracts.

Automatic escalation.—If the present outlook for consumer prices turns out to be right, the size of wage increases attributable to escalation in 1961 will probably be small—about the same as in 1960 and much smaller than occurred in 1958 and 1957.

As of the beginning of 1961, between 2.5 and 2.8 million workers were covered by major collective bargaining agreements with automatic cost of living escalator provisions. (In early 1959 about 4 million workers were covered by such clauses—the decline is largely due to the elimination of such provisions in railroads and electrical equipment cited above.) Of special significance to the outlook for escalation in 1961 is the fact that about 650,000 workers are employed under contracts which specify an upper limit to any cost-of-living increases that might go into effect. Contracts of this nature are largely concentrated in the steel, aluminum, and metal container industries.

Increases already negotiated.—A third factor bearing on 1961 collective bargaining is the extent of wage commitments for 1961, made in 1960 and earlier years, in major collective bargaining contracts. These agreements, affecting at least 2.3 million workers (about 3 out of 10 workers employed under major contracts), most frequently provided wage-rate increases averaging 8 but less than 9 cents an hour. Increases of this magnitude affect 30 percent of the workers. Among the major industries with contracts providing for deferred wage increases are steel and related products, aluminum, metal containers, aircraft, shipbuilding, railroad (operating personnel), east coast longshoring, trade and some utilities. The possible impact of these previously negotiated increases upon bargaining in 1961 may perhaps be indicated by a comparison of deferred wage increases that went into effect in previous years with those negotiated in the same period.

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[2] In effect, this meant that wage rates in the industry had remained relatively stable for about 2½ years. Between July 1958 when the last deferred increase became effective under the previous agreements and December 1960, the only wage increase was a 1-cent-an-hour cost-of-living adjustment in January 1959. It should be noted, however, that although there was no immediate wage rate increase as such, workers' take-home pay did increase approximately 6.5 cents early in the year as a result of the companies' assuming the employee's cost for insurance benefits.

Comparison of deferred wage increases with negotiated wage increases effective under selected major collective bargaining agreements, 1957–60

Type of wage adjustment [1]	Median cents-per-hour wage increase (by workers affected) effective in—				
	1961	1960	1959	1958	1957
Deferred	7	6	6	7	7
Negotiated		[2] 8	8	8	10

[1] Excludes cost-of-living escalator increases.
[2] Preliminary.

As indicated above the median negotiated increase, with the exception of 1958, was at least 2 cents higher than the median deferred wage increase.

Nonwage benefits.—There are reasons to believe that the pattern of collective bargaining in 1961, as well as for the decade ahead, is not likely to repeat the pattern observed in the 1950's. Over the past decade the most noteworthy of the fringe benefit improvements in the early years were largely in the area of pensions and insurance, beginning on a large scale in 1949 and 1950. They were diffused throughout most sectors of the economy by the mid-1950's. In 1955 provisions for supplemental unemployment benefit plans were included for the first time in the automobile contracts, and by 1959 SUB had spread to a number of other industries including steel, aluminum, metal containers, cement, and rubber. As labor became more concerned over unemployment problems relating to automation, alternative programs designed to offset reduced earnings and employment became more frequent. Severance pay plans were either established or liberalized with greater frequency, and in 1959 automation funds were set up in the meatpacking and west coast longshoring industries.

Looking further ahead, increasing emphasis will likely be placed on supplementary benefits, in particular those designed to offset unemployment resulting from reduced manpower requirements for production workers, and accentuated by an anticipated sharp expansion of the Nation's labor force.

Already in 1960, settlements in three industries gave special consideration to the problem of employee displacement and provided for some sort of payment to their workers thus affected. Two settlements in the longshoring industry were significant for the way they dealt with the issue of mechanization. Two-year contracts signed in the summer of 1960 among major aircraft missile firms (located principally on the west coast and in the southwest) included establishment of extended layoff benefit plans.

In view of the current unemployment situation, it is likely that clauses relating to job protection will receive more attention in 1961.

TABLE 1.—*Seasonal adjustment factors for unemployment for use on current data*

Month	Male		Female	
	14 to 19 years	20 years and over	14 to 19 years	20 years and over
January	96.5	124.6	73.8	110.6
February	95.2	131.9	75.2	108.6
March	91.0	124.6	76.2	103.0
April	85.0	108.1	88.3	99.3
May	93.0	94.7	110.0	99.4
June	172.6	92.8	203.0	100.3
July	141.7	90.9	149.3	102.4
August	99.4	84.9	99.4	99.7
September	76.9	79.3	86.0	96.0
October	75.8	77.0	73.5	93.8
November	82.9	90.3	92.8	97.9
December	89.8	101.1	72.7	88.5

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 2.—*Deviation of actual from trend*[1] *labor force, by age and sex, annual average, 1959–60*

[In thousands]

Age and sex	1959			1960 [2]		
	Actual labor force	Trend labor force	Deviation of actual from trend	Actual labor force	Trend labor force [3]	Deviation of actual from trend
Total, 14 and over	71,946	72,505	−559	73,126	73,687	−561
Male, 14 and over	49,081	49,514	−433	49,507	50,051	−544
14 to 24	8,705	8,775	−70	8,910	8,997	−87
14 to 19	3,718	3,801	−83	3,821	3,955	−134
20 to 24	4,987	4,974	13	5,089	5,042	47
25 to 64	38,054	38,199	−145	38,309	38,508	−199
65 and over	2,321	2,540	−219	2,287	2,546	−259
Female, 14 and over	22,865	22,991	−126	23,619	23,636	−17
14 to 24	4,735	4,717	18	4,999	4,838	161
25 to 64	17,294	17,356	−62	17,713	17,847	−134
25 to 34	4,096	4,338	−242	4,140	4,375	−235
35 to 64	13,198	13,018	180	13,573	13,472	101
65 and over	836	918	−82	907	951	−44

1 Trend labor forces are based on 1947–56 trends in labor force participation rates by age and sex, by school enrollment for young persons, and by marital and child status for adult women.
2 Data for 1960 include Alaska and Hawaii (about 300,000).
3 Differs from projected 1960 total labor force in Bull. 1242, "Population and Labor Force Projections for the United States, 1960 to 1975," because of the inclusion of Alaska and Hawaii and because the current estimate of July 1960 population is about 300,000 smaller than the projected 1960 population used in Bull. No. 1242.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 3.—*Age and sex of the unemployed, 1960 and 1957 annual average*

Age and sex	1960		1957	
	Number	Percent	Number	Percent
Total	3,931,000	100.0	2,936,000	100.0
Young workers, 14 to 24 years	1,373,000	35.0	1,003,000	34.2
14 to 19 years	790,000	20.1	573,000	19.6
Male	480,000	12.2	351,000	12.0
Female	310,000	7.9	222,000	7.6
20 to 24 years	583,000	14.9	429,000	14.6
Male	369,000	9.4	283,000	9.6
Female	214,000	5.5	147,000	5.0
Adult workers	2,553,000	65.0	1,931,000	65.8
25 to 64 years	2,432,000	61.9	1,820,000	62.0
Male	1,593,000	40.6	1,175,000	40.0
Female	839,000	21.3	645,000	22.0
65 years and over	121,000	3.1	111,000	3.8
Male	96,000	2.4	83,000	2.8
Female	25,000	.7	28,000	1.0

U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 4.—*Unemployment rates by age and sex, 1960 and 1957 annual and 4th quarter average*

Age and sex	Annual average		4th quarter average	
	1960	1957	1960	1957
Both sexes	5.6	4.3	5.7	4.4
Male	5.4	4.1	5.5	4.4
14 to 19 years	14.0	11.3	13.5	11.2
20 to 24 years	8.9	7.8	9.3	8.9
25 to 34 years	4.8	3.3	5.0	3.6
35 to 44 years	3.8	2.8	4.1	3.2
45 to 54 years	4.1	3.3	4.6	3.8
55 to 64 years	4.6	3.5	4.5	3.5
65 years and over	4.2	3.4	4.2	3.5
Female	5.9	4.7	6.0	4.5
14 to 19 years	12.9	10.1	11.7	8.1
20 to 24 years	8.3	6.0	8.0	5.3
25 to 34 years	6.3	5.3	7.0	5.1
35 to 44 years	4.8	3.8	5.2	4.0
45 to 54 years	4.2	3.2	4.7	3.3
55 to 64 years	3.4	3.0	3.7	3.3
65 years and over	2.8	3.4	2.7	3.3

U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 5.—*Unemployment rates [1] by industry, 1960 and 1957 annual average*

Industry	1960	1957
Total [2]	5.6	4.3
Experienced wage and salary workers	5.7	3.9
Agriculture	8.0	6.7
Nonagricultural industries	5.6	4.5
Mining, forestry, and fisheries	9.5	6.3
Construction	12.2	9.8
Manufacturing	6.2	5.0
Durable goods	6.3	4.9
Nondurable goods	6.0	5.3
Transportation and public utilities	4.3	3.1
Wholesale and retail trade	5.9	4.5
Finance, insurance, and real estate	2.4	1.8
Service industries	4.1	3.4
Public administration	2.6	2.0

[1] Percent of civilian labor force in each category who were unemployed.
[2] Includes self-employed, unpaid family workers, and persons without previous work experience not shown separately.

U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 6.—*Unemployment rates by occupation,[1] 1960 and 1957 annual average*

Occupation	1960	1957
Total	5.6	4.3
Professional, technical, and kindred workers	1.7	1.2
Farmers and farm managers	.3	.3
Managers, officials, and proprietors, except farm	1.4	1.0
Clerical and kindred workers	3.8	2.8
Sales workers	3.7	2.6
Craftsmen, foremen, and kindred workers	5.3	3.8
Operatives and kindred workers	8.0	6.3
Private household workers	4.9	3.7
Service workers, except private household	6.0	5.1
Farm laborers and foremen	5.2	3.7
Laborers, except farm and mine	12.5	9.4

[1] Percent of civilian labor force in each category who were unemployed.

U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 7.—*Duration of unemployment, color, and sex of unemployed, 1960 and 1957 annual average*

Duration of unemployment, color, and sex	1960		1957	
	Number	Percent	Number	Percent
Duration of unemployment:				
Total	3,931,000	100.0	2,936,000	100.0
Less than 5 weeks	1,799,000	45.8	1,485,000	50.6
5 to 14 weeks	1,176,000	29.9	890,000	30.3
15 weeks and over	956,000	24.3	560,000	19.1
15 to 26 weeks	502,000	12.8	321,000	10.9
27 weeks and over	454,000	11.5	239,000	8.1
Average duration (weeks)	12.8		10.4	
Color and sex:				
Total	3,931,000	100.0	2,936,000	100.0
White	3,127,000	79.6	2,350,000	80.1
Male	2,032,000	51.7	1,519,000	51.7
Female	1,095,000	27.9	832,000	28.3
Non-White	804,000	20.4	585,000	19.9
Male	508,000	12.9	374,000	12.7
Female	295,000	7.5	211,000	7.2

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 8.—*Selected characteristics of long-term unemployed (15 weeks and over), 1960 and 1957 annual average*

[In percent]

	1960	1957
White	75.1	77.7
Male	69.5	69.0
Under 25 years of age	26.4	23.0
65 and over	4.9	6.8
Last employed in:		
Construction	12.3	12.0
Manufacturing	31.2	37.1
Durable goods	19.1	21.2
Nondurable goods	12.1	15.7
Transportation and public utilities	6.3	4.8
Trade	15.3	13.7
Services	13.3	12.1
Last employed as:		
White-collar workers	18.3	17.8
Craftsmen	11.7	13.3
Operatives	29.0	30.8
Nonfarm laborers	15.7	14.6
Service workers	12.3	12.6

Source: U.S. Department of Labor, Bureau of Labor Statistics.

TABLE 9.—*Average hourly earnings of factory production workers, by industry group, December 1960[1] and December 1959*

Major industry group	Average hourly earnings				Percentage increase December 1959 to December 1960	
	December 1960 [1]		December 1959			
	Including premium pay for overtime	Excluding premium pay for overtime	Including premium pay for overtime	Excluding premium pay for overtime	Including premium pay for overtime	Excluding premium pay for overtime
All manufacturing	$2.32	$2.26	$2.27	$2.20	2.2	2.7
Durable goods	2.48	2.42	2.43	2.35	2.1	3.0
Ordnance and accessories	2.69	2.63	2.61	2.54	3.1	3.5
Lumber and wood products	1.99	1.93	2.00	1.92	−.5	.5
Furniture and fixtures	1.88	1.82	1.85	1.78	1.6	2.2
Stone, clay, and glass products	2.31	2.24	2.25	2.17	2.7	3.2
Primary metal industries	2.83	2.79	2.85	2.77	−.7	.7
Fabricated metal products	2.48	2.42	2.41	2.33	2.9	3.9
Machinery (except electrical)	2.60	2.54	2.54	2.46	2.4	3.3
Electrical machinery	2.36	2.30	2.27	2.20	4.0	4.5
Transportation equipment	2.80	2.73	2.72	2.64	2.9	3.4
Instruments and related products	2.41	2.35	2.33	2.25	3.4	4.4
Miscellaneous manufacturing industries	1.98	1.93	1.94	1.88	2.1	2.7
Nondurable goods	2.11	2.05	2.04	1.97	3.4	4.1
Food and kindred products	2.22	2.14	2.16	2.08	2.8	2.9
Tobacco manufacturers	1.79	1.76	1.70	1.68	5.3	4.8
Textile mill products	1.62	1.58	1.59	1.53	1.9	3.3
Apparel and other finished textile products	1.57	1.55	1.53	1.50	2.6	3.3
Paper and allied products	2.32	2.22	2.23	2.12	4.0	4.7
Printing	2.81	(2)	2.74	(2)	2.6	(2)
Chemicals and allied products	2.55	2.49	2.45	2.39	4.1	4.2
Products of petroleum and coal	2.93	2.87	2.90	2.85	1.0	.7
Rubber products	2.55	2.50	2.49	2.41	2.4	3.7
Leather and leather products	1.65	1.62	1.62	1.59	1.9	1.9

[1] Preliminary. [2] Not available.

TABLE 10.—*Gross average hourly earnings in selected nonmanufacturing industries, December 1960[1] and December 1959*

Industry	Average hourly earnings		Percentage change December 1959 to December 1960
	December 1960 [1]	December 1959	
Mining:			
Metal	$2.72	$2.64	3.0
Anthracite	2.75	2.77	−.7
Bituminous coal	3.26	3.31	−1.5
Contract construction	3.38	3.21	5.3
Nonbuilding construction	3.06	2.88	6.3
Building	3.46	3.30	4.8
General contractors	3.19	3.03	5.3
Special trade contractors	3.60	3.44	4.7
Class I railroads	[2] 2.65	2.57	3.1
Local railways	2.36	2.24	5.4
Communication:			
Telephone	2.32	2.23	4.0
Telegraph	2.44	2.28	7.0
Other public utilities: Gas and electric utilities	2.76	2.64	4.5
Wholesale and retail trade:			
Wholesale trade	2.32	2.27	2.2
Retail trade	1.78	1.73	2.9
Service and miscellaneous:			
Laundries	1.23	1.19	3.4
Cleaning and dyeing plants	1.41	1.39	1.4

[1] Preliminary. [2] October 1960.

CHART 1

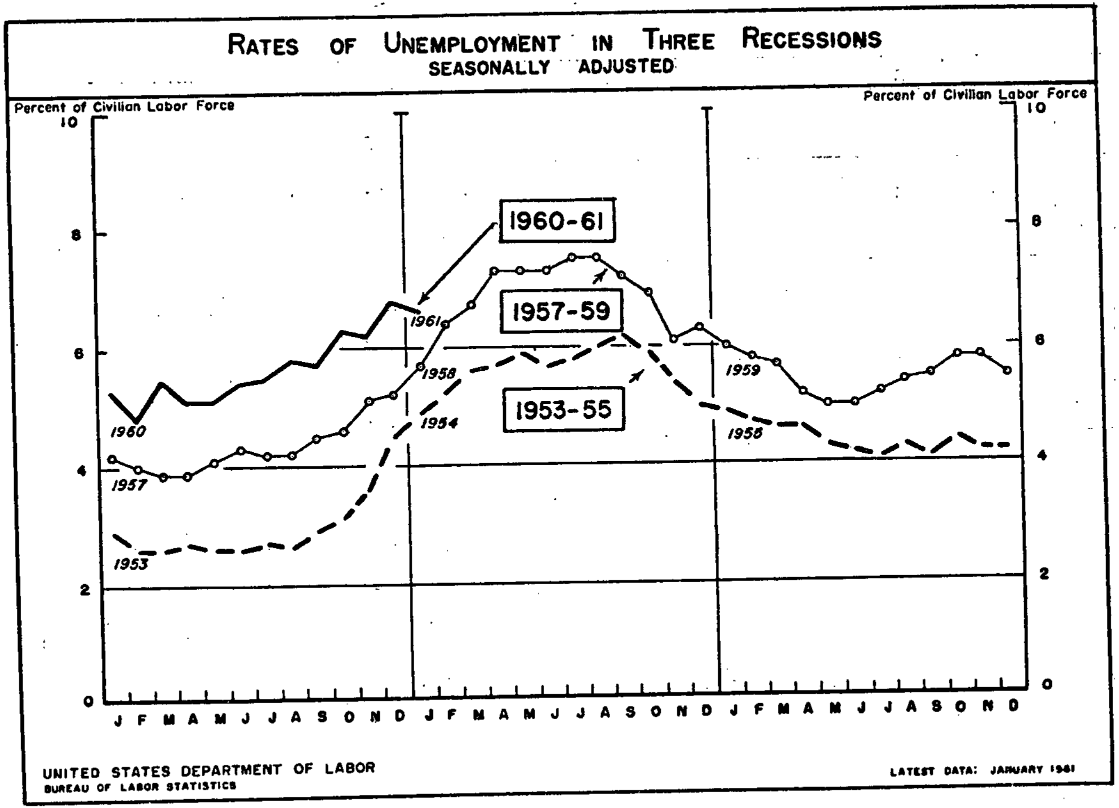

RATES OF UNEMPLOYMENT IN THREE RECESSIONS
SEASONALLY ADJUSTED
Percent of Civilian Labor Force
Percent of Civilian Labor Force
10
8
6
4
2
0
1960-61
1957-59
1953-55
1960
1961
1957
1958
1959
1953
1954
1955
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: JANUARY 1961

CHART 2

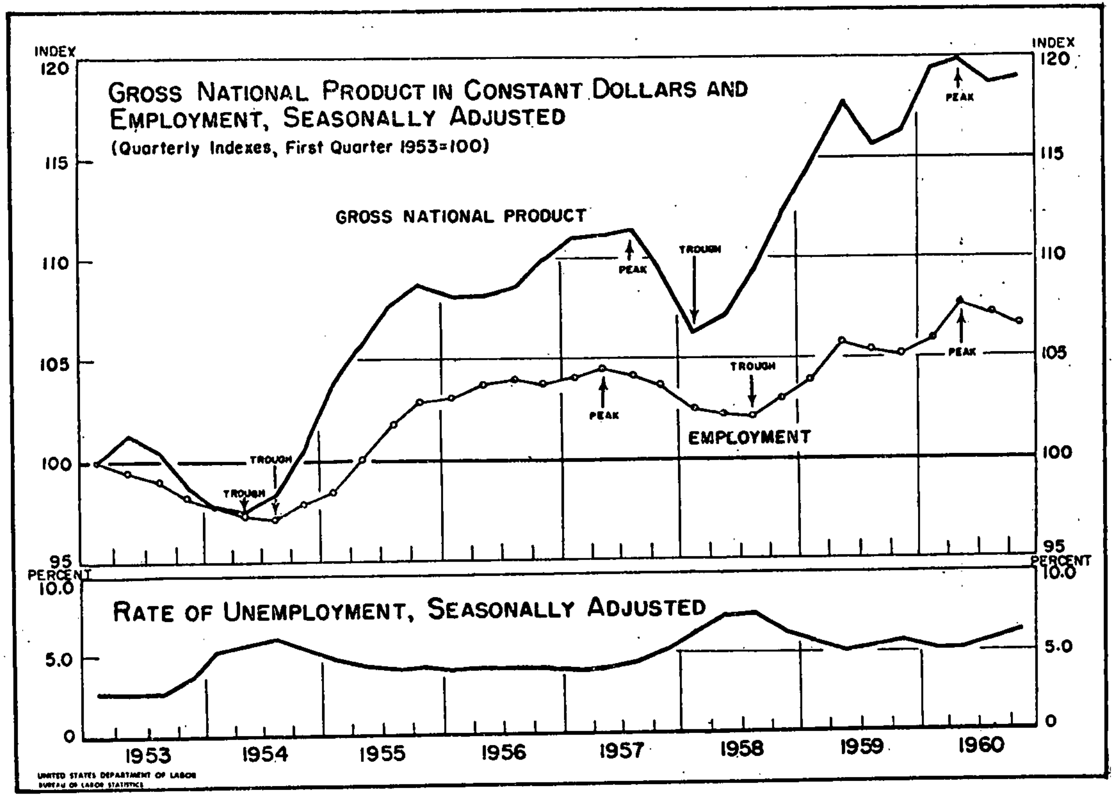

GROSS NATIONAL PRODUCT IN CONSTANT DOLLARS AND EMPLOYMENT, SEASONALLY ADJUSTED
(Quarterly Indexes, First Quarter 1953=100)
INDEX
120
115
110
105
100
95
GROSS NATIONAL PRODUCT
EMPLOYMENT
PEAK
TROUGH
RATE OF UNEMPLOYMENT, SEASONALLY ADJUSTED
PERCENT
10.0
5.0
0
1953
1954
1955
1956
1957
1958
1959
1960
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 3

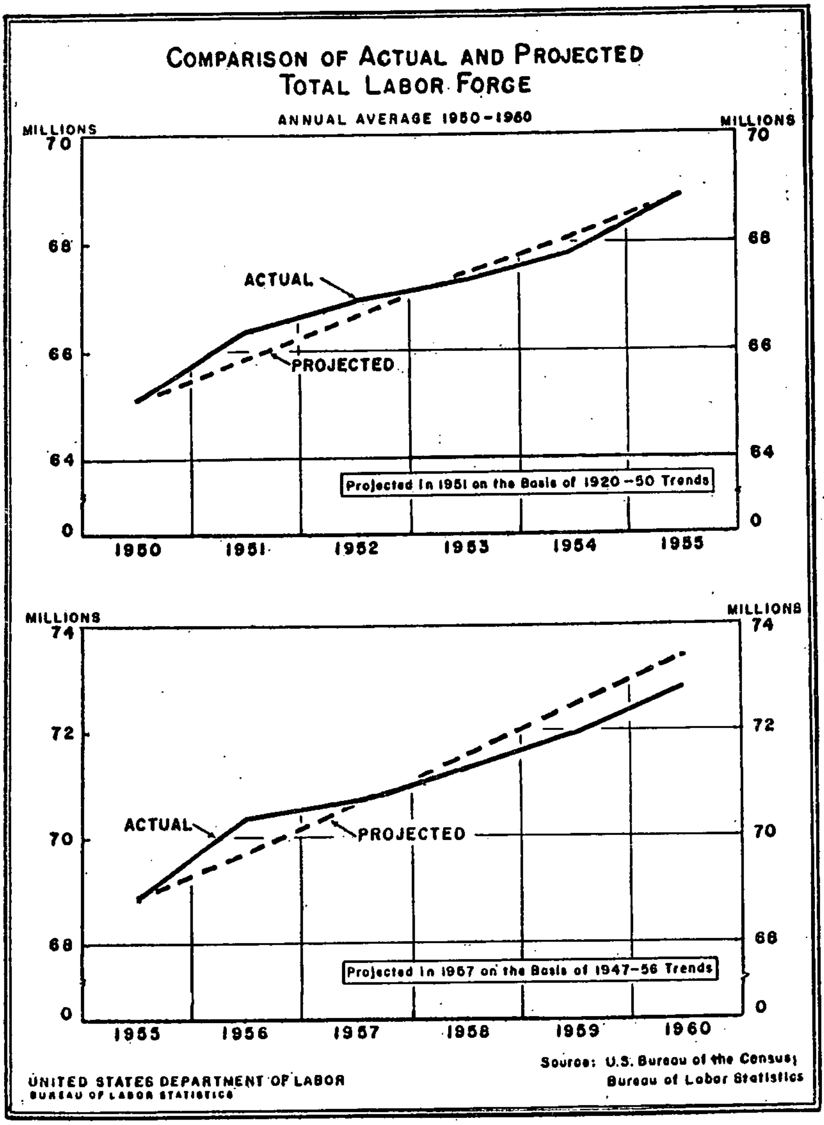
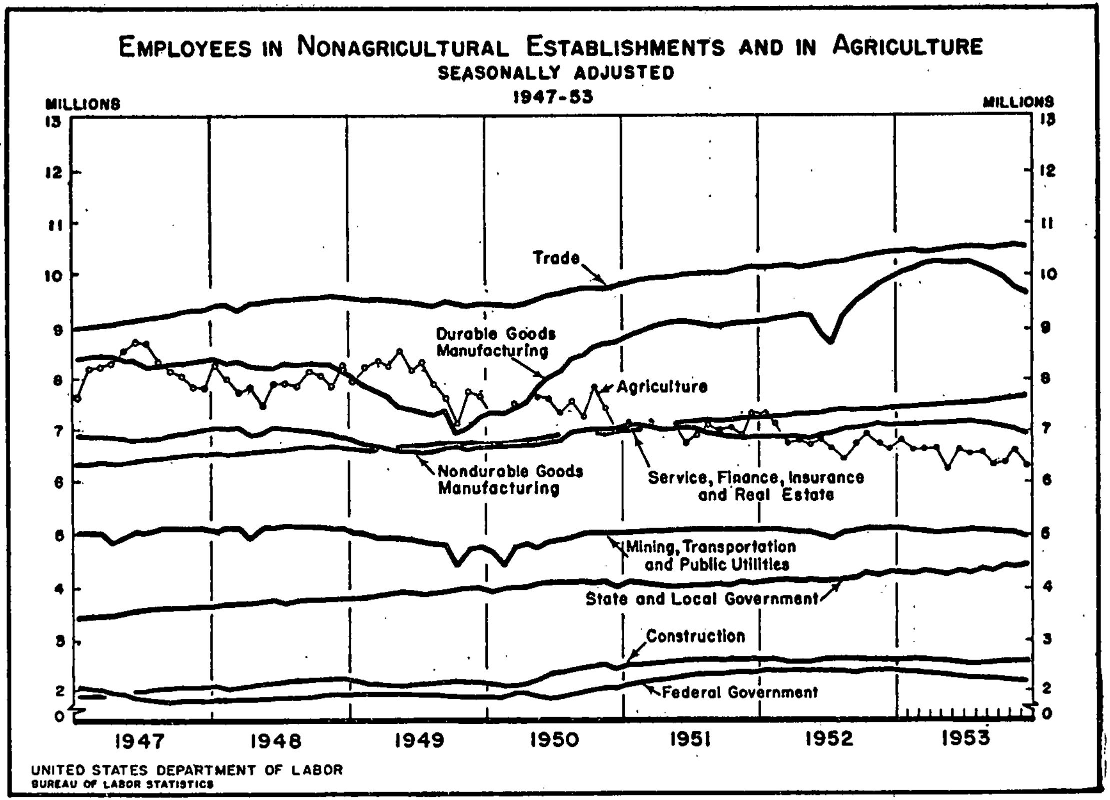

COMPARISON OF ACTUAL AND PROJECTED
TOTAL LABOR FORCE
ANNUAL AVERAGE 1950-1960
MILLIONS
70
68
66
64
0
ACTUAL
PROJECTED
Projected in 1951 on the Basis of 1920-50 Trends
1950
1951
1952
1953
1954
1955
MILLIONS
74
72
70
68
0
ACTUAL
PROJECTED
Projected in 1957 on the Basis of 1947-56 Trends
1955
1956
1957
1958
1959
1960
Source: U.S. Bureau of the Census;
Bureau of Labor Statistics
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 4A



EMPLOYEES IN NONAGRICULTURAL ESTABLISHMENTS AND IN AGRICULTURE
SEASONALLY ADJUSTED
1947-53
MILLIONS
MILLIONS
Trade
Durable Goods Manufacturing
Agriculture
Nondurable Goods Manufacturing
Service, Finance, Insurance and Real Estate
Mining, Transportation and Public Utilities
State and Local Government
Construction
Federal Government
1947
1948
1949
1950
1951
1952
1953
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 4B

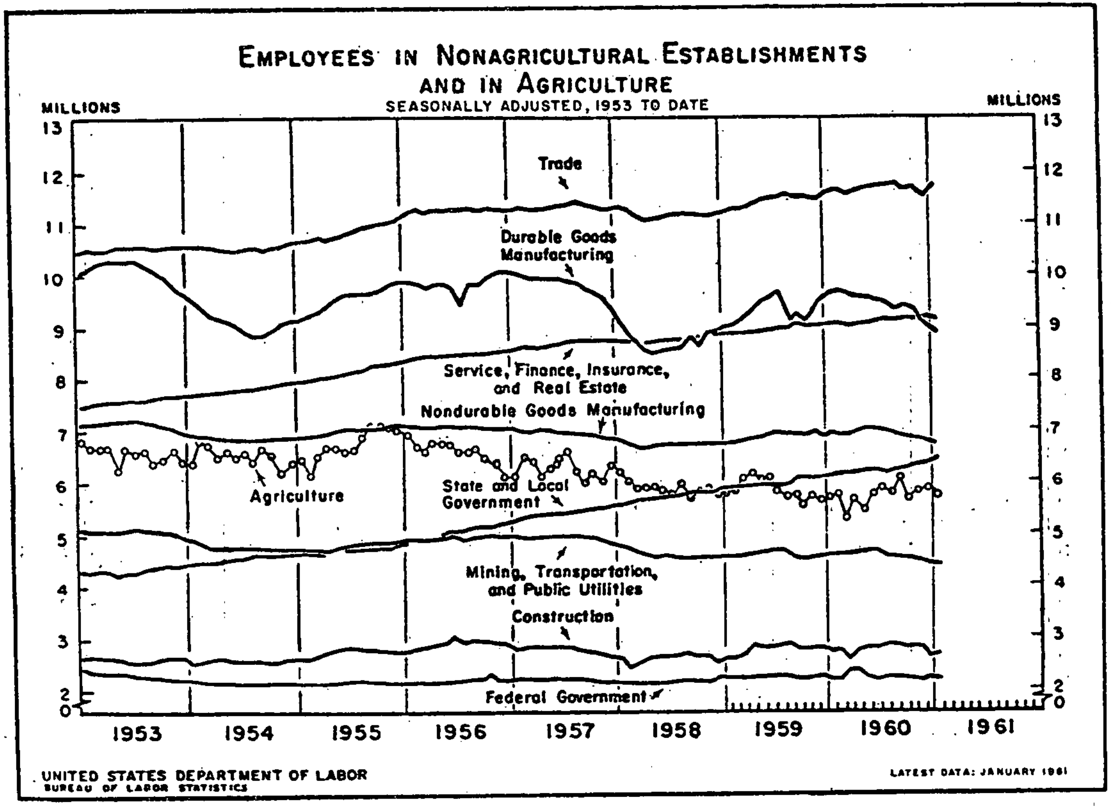

EMPLOYEES IN NONAGRICULTURAL ESTABLISHMENTS AND IN AGRICULTURE
SEASONALLY ADJUSTED, 1953 TO DATE
MILLIONS
MILLIONS
Trade
Durable Goods Manufacturing
Service, Finance, Insurance, and Real Estate
Nondurable Goods Manufacturing
Agriculture
State and Local Government
Mining, Transportation, and Public Utilities
Construction
Federal Government
0
2
3
4
5
6
7
8
9
10
11
12
13
1953
1954
1955
1956
1957
1958
1959
1960
1961
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: JANUARY 1961

CHART 5

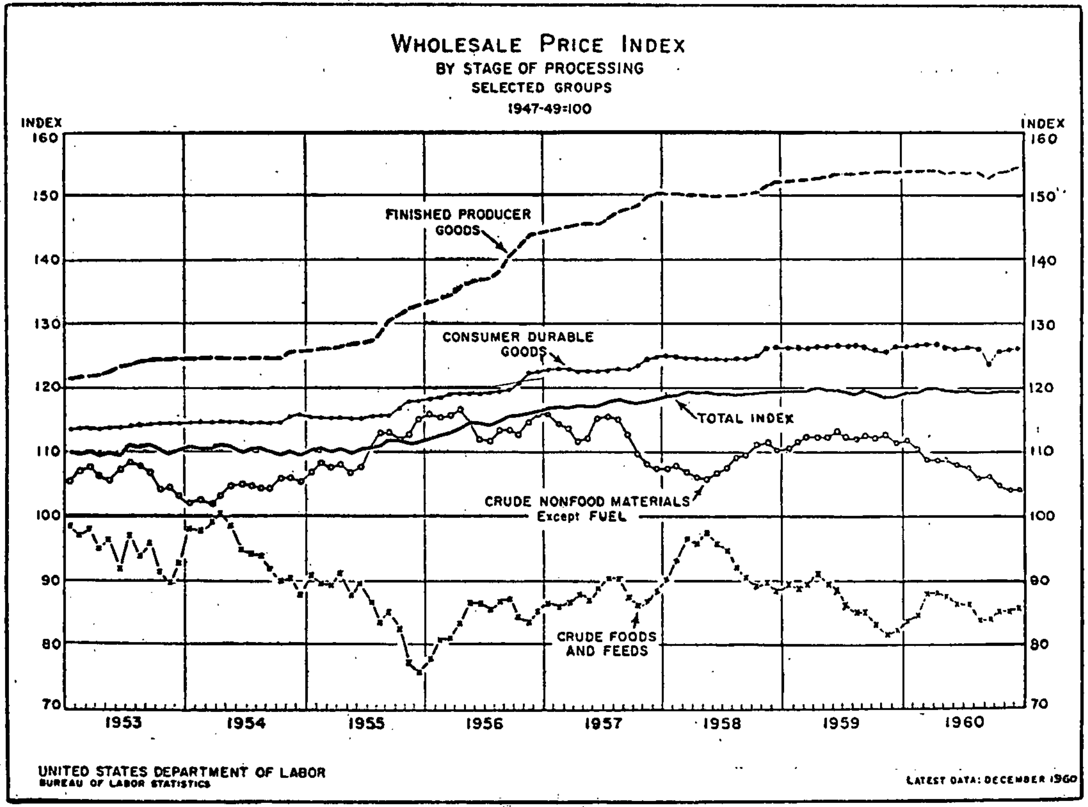
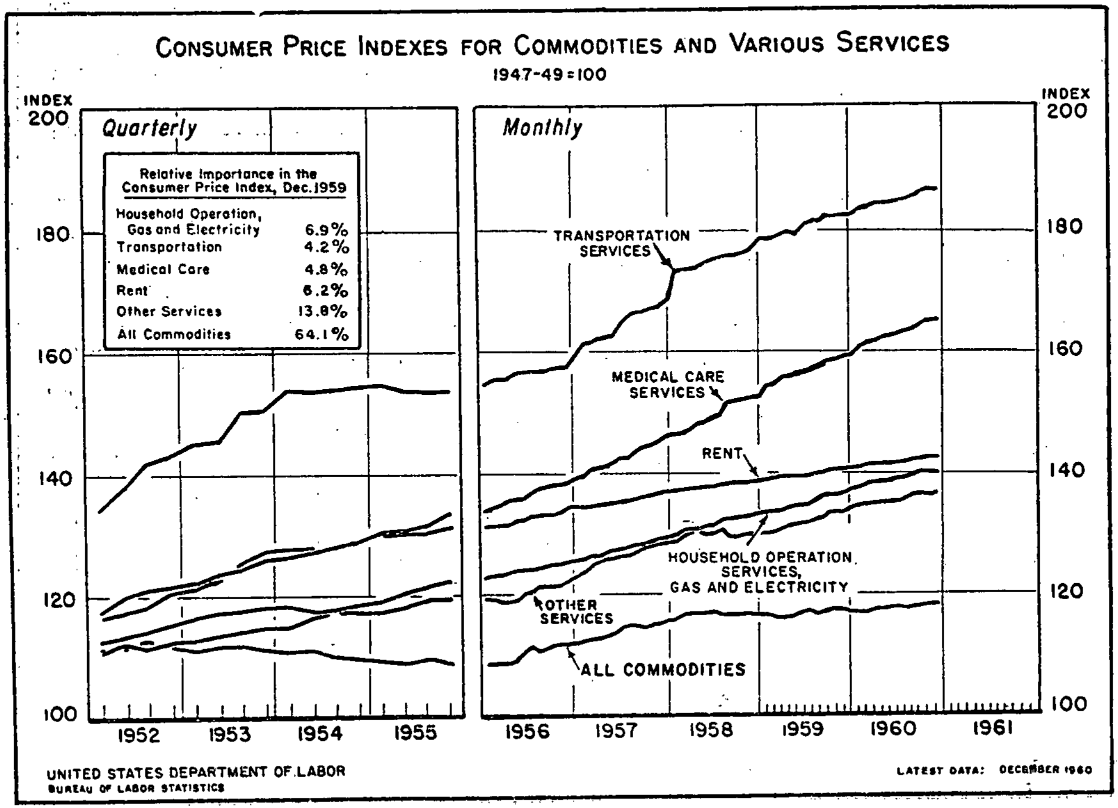

WHOLESALE PRICE INDEX
BY STAGE OF PROCESSING
SELECTED GROUPS
1947-49=100
INDEX
160
150
140
130
120
110
100
90
80
70
FINISHED PRODUCER GOODS
CONSUMER DURABLE GOODS
TOTAL INDEX
CRUDE NONFOOD MATERIALS Except FUEL
CRUDE FOODS AND FEEDS
1953
1954
1955
1956
1957
1958
1959
1960
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1960

CHART 6


CONSUMER PRICE INDEXES FOR COMMODITIES AND VARIOUS SERVICES
1947-49=100
INDEX
Quarterly
Monthly
Relative Importance in the Consumer Price Index, Dec. 1959
Household Operation, Gas and Electricity 6.9%
Transportation 4.2%
Medical Care 4.8%
Rent 6.2%
Other Services 13.8%
All Commodities 64.1%
TRANSPORTATION SERVICES
MEDICAL CARE SERVICES
RENT
HOUSEHOLD OPERATION SERVICES, GAS AND ELECTRICITY
OTHER SERVICES
ALL COMMODITIES
200
180
160
140
120
100
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1960

The CHAIRMAN. Our next witness, who will speak on the outlook for demand and supply of funds and interest rates, is Mr. Roy Reierson, vice president and economist, Bankers Trust Co., New York.

STATEMENT OF ROY L. REIERSON, VICE PRESIDENT AND ECONOMIST, BANKERS TRUST CO., NEW YORK, N.Y.

OUTLOOK FOR DEMAND AND SUPPLY OF FUNDS AND INTEREST RATES

Mr. REIERSON. Mr. Chairman, I have in preparation a statement dealing with developments in and prospects for the credit markets.

Copies of the full text are not available at this time. However, I have provided the committee with copies of the charts that will be included in this statement.

In addition, I have, Mr. Chairman, a summary that I am prepared to present at this time.

The credit markets in 1960 were shaped by five strategic developments: (1) Shortly after the turn of the year, business expectations began to weaken and inflation psychology to subside. (2) Industrial activity leveled off in the first half of the year and sagged thereafter. (3) The Federal Reserve early in 1960 began to ease credit, and subsequently carried out this policy through a broad program involving open market purchases, lower discount rates, and reductions in reserve requirements. (4) The Treasury's financial position improved significantly, permitting some retirement of Government debt. (5) After midyear, the dollar came under growing pressure in world markets and the outflow of gold increased importantly.

Total credit expansion in 1960 amounted to about $41 billion, which was some 30 percent below the record volume of 1959. The major reason for this decline was a swing—from a $10½ billion rise in 1959 to a reduction by some $3 billion last year—in the publicly held securities of the U.S. Government and its agencies. Also, long-term credit rose somewhat less than in the prior year, largely because of the smaller growth in mortgages. Short-term credit, however, expanded about as much as in 1959, and possibly more.

With credit easier, the commercial banking system provided more than twice as much credit in 1960 as in 1959. In fact, the $10 billion rise in bank loans and investments last year has been exceeded only in the recession year 1958, and has been equaled only in the recession year 1954. The savings institutions continued to be the major suppliers of funds to the credit markets, but their investments in 1960 increased by a somewhat smaller amount than in the previous year. The category of "other investors," however—business corporations, foreigners, individuals, and the like—absorbed only about $8 billion of the total credit expansion of 1960, compared with an unprecedented $30 billion in the prior year, when yields had been substantially more attractive.

All classes of interest rates declined in 1960 from the cyclical highs attained in 1959. The bulk of this adjustment was completed by the third quarter; since then interest rates have displayed no clear-cut trend. Furthermore, although money market rates, as usual, dropped much more than long-term yields, interest rates have not fallen to the lows of the recession year 1954 and 1958.

The relatively moderate extent of the decline in interest rates in 1960 is explained in part by the milder nature of the current economic sag in comparison with the sharper downtrends in the comparable periods of earlier postwar recessions. Investment managers so far have met with no real difficulties in finding outlets for their funds; moreover, bankers and portfolio managers are mindful of their experience during previous recessions, when demands for credit remained substantial and the subsequent business recoveries soon led to new peaks of borrowing. In addition, commercial bankers generally availed themselves of the opportunity provided by the easing of credit in 1960 to rebuild ther liquidity and to prepare for the increased loan demands of the future. Finally, there was a significant outflow of funds last year in response to the higher returns available in foreign markets.

Looking into 1961, an important consideration is that the publicly held debt of the U.S. Government and its agencies is likely to expand anew, by an estimated $1 to $2 billion, which is a sharp swing from the $3 billion reduction of last year. In the first half of the year, to be sure, the Treasury will be operating at a surplus and will thus be retiring some debt. In the latter part of 1961, however, the Treasury will be incurring a much larger deficit than in the comparable months of 1960, and will be heavily in the market for new money.

The year 1961 is expected also to show a substantial increase in new financing by State and local governments; approvals of new issues in the November elections set a new high and the backlog is very large. Net new corporate issues will presumably ease in the wake of lower plant and equipment expenditures but, with home building expected to expand somewhat in the year ahead, this sag in the corporate sector is likely to be fully offset by the prospective increase in real estate mortgage debt.

Indications are that ample credit will be available to finance these requirements. Individual savings and the flow of funds to savings institutions may well exceed those of 1960, and unless the economy experiences another buying boom or a resurgence of inflationary psychology—neither of which appears probable in the months ahead—this favorable trend of savings is likely to continue.

Specifically, this suggests that larger amounts will be available for mortgage financing in 1961. This prospect is endorsed by the growth in deposits of mutual savings banks and in shares of savings and loan associations; the latter institutions not only are continuing their rapid growth but, in addition, reduced their borrowings last year and rebuilt their liquidity. Finally, with lower corporate financing in prospect, life insurance companies will probably show heightened interest in mortgages, and corporate pension funds may also be expected to become more important in the mortgage market.

The strong trend of savings augurs well also for reception of the prospective rise in new security offerings by State and local governments. No difficulty is anticipated in attracting buyers, although if recent proposals to curb the tax exemption advantage now enjoyed by obligations of State and local governments receive widespread congressional support, the market for tax-exempt securities, obviously, would be adversely affected.

Nor is the business recovery likely to be hampered by a shortage of bank credit. The commercial banks have reduced their borrowings from the Federal Reserve to a nominal level, their liquidity has been improved, and the decline in their loan-deposit ratios will presumably continue in the months ahead. As a result, credit-worthy borrowers should be able to satisfy their requirements for bank financing without difficulty in 1961.

The increased flow of savings and the currently reduced level of economic activity make it reasonable to expect some further easing of bond yields and other long-term interest rates in the months immediately ahead. Short-term rates, however, are not likely to be affected significantly by these downward pressures in view of the demonstrated pull of foreign money markets and the importance of balance of payments considerations for Federal Reserve policy. Moreover, with the economy apparently approaching the bottom of the current contraction, the next few months may well bring signs of an upturn in business and in credit demands. These, together with the large Treasury borrowings already in sight for the second half of this year, suggest that later in 1961 underlying economic forces may well be pointing toward higher interest rates. In fact, it may be pertinent to recall the experience of 1958–59, when a large Treasury deficit compounded the rising credit needs of a business recovery and thus greatly enhanced the upward pressures on interest rates.

A new factor in the interest-rate outlook is the endorsement by the President of a program to attract more funds into the capital markets at lower yields and at the same time to halt further declines in short-term rates in order to curtail the outflow of gold. Presumably, this would involve, on the one hand, Federal Reserve purchases of longer term Government obligations to reduce bond yields and, on the other hand, sales of shorter term securities to prevent money market yields from falling. Also, the Treasury would probably be expected to cooperate through reliance upon the issuance of short-term securities.

Admittedly, to the extent that Federal Reserve purchases of Government bonds induce a shift into mortgages and other long-term investments, a major objective of the program would be met. Essentially, however, the aims are contradictory, as the President's message acknowledges, for as bond yields decline, the inducement to invest at long term will be weakened, and holders of Government bonds may instead prefer to shift into short-term securities until long-term yields become more attractive. This would tend to divert funds from the investment markets and reduce interest rates in the short-term market. The many hazards and complexities involved in this program thus place heavy additional responsibilities upon both the Federal Reserve and the Treasury if constructive results are to be achieved.

The Federal Reserve, until a business upturn becomes evident, faces the delicate task of following policies conducive to recovery without contributing to a further outflow of short-term funds, and hence of gold, to the higher yielding money markets abroad. However, the task is not insuperable. A moderate rise in short-term rates at home would reduce the attraction of foreign money centers without adversely affecting the business situation at home; bank-lending rates are not likely to be raised as a result, nor would such an increase in short-term rates, under present conditions, divert significant amounts of funds from the long-term markets. Furthermore, such a rise in short-term rates need not prevent the Federal Reserve from augmenting the lending power of the commercial banks if the Treasury, in turn, employs debt management policies that complement the aims of the Federal Reserve.

The Treasury already faces a chronic problem in the continuing shortening of its debt with the passage of time. Added emphasis on the use of short-term securities would further unbalance the maturity structure of the debt and create increasingly difficult refinancing problems for the not too distant future. Financing through long-term bonds, on the other hand, would be criticized as diverting funds from other investment markets at a time when the economy is sagging. A way out of this dilemma may be found by resort to the issuance of Treasury securities in the maturity range suited to commercial bank investment. Such a Treasury policy, complementing the policy of the Federal Reserve, would lead to higher deposits, improved loan-deposit ratios, and increased lending capacity of the commercial banks without depressing money market rates.

The chances for a successful reconciliation of the conflicting aims of the President's program would be increased if Federal Reserve purchases of longer term Government securities were to be undertaken at times when reserves would ordinarily be provided for credit policy reasons and thus would be substitutes for purchases of Treasury bills. It should be understood that the program is not designed to interfere with flexible credit policy or achieve any particular level of long-term yields. Above all, it should be made unmistakably clear to the market that this is not the first step in a return to pegged interest rates—a prospect which would open the gates to inflationary psychology at home and to renewed attacks on the dollar from abroad.

The strength of the dollar remains the most important single problem in the monetary field, and goes beyond the matter of interest rates alone. There is some basis for hope that we have seen the worst of the current wave of skepticism; foreigners appear to have gained some assurance from the developments of recent weeks. Ultimately, however, confidence in the dollar can be maintained only if the deficit in our international accounts is eliminated or at least reduced very substantially and if, moreover, we follow domestic policies and practices—in such matters as wages, prices, the budget, debt management and credit—that will stop the persistent erosion of the purchasing power of the dollar and enhance our position in a highly competitive world.

If we wish to maintain the integrity of the dollar, and if we desire to remain free to use fiscal and credit policies as tools for economic stabilization and growth, we must take to heart President Kennedy's recent words:

> We cannot afford unsound wage and price movements which push up costs, weaken our international competitive position, restrict job opportunities, and jeopardize the health of our domestic economy.

(The formal statement of Mr. Reierson, together with charts and tables, follows:)

THE ECONOMIC BACKGROUND

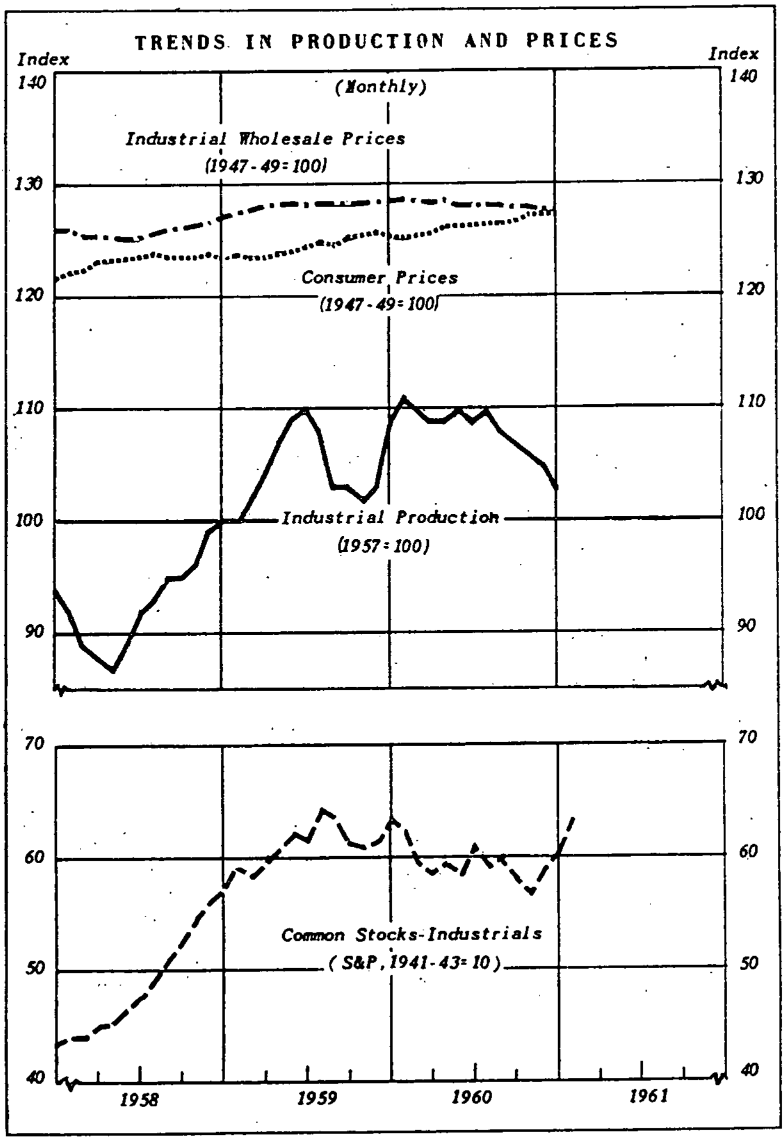
The year 1960 brought a major change in the climate of the credit markets. The start of the year found the economy operating at new peaks, with demands for credit large and active and credit policy tight. As the year progressed, business sales and orders proved disappointing, the pace of consumer spending tended to slow down, housing starts slumped further, profit margins were squeezed, and business began to reduce inventories and, later, capital spending programs. At the end of the year, the economy was in a cyclical decline, credit demands had slackened and credit policy was easy. However, the sag in business was relatively mild and the gross national product remained above the $500-billion rate throughout the year.

All classes of interest rates declined in 1960 from the cyclical highs attained in 1959. The bulk of this adjustment, however, was completed by the third quarter; since then, interest rates have displayed no clear-cut trend. Furthermore, while money market rates, as usual, have dropped much more than long-term yields, interest rates have not fallen to the lows reached in the recession years 1954 and 1958.

Strategic factors in 1960

The credit markets in 1960 were shaped by five strategic developments. (1) Shortly after the turn of the year, business expectations began to weaken and inflation psychology to subside. (2) Industrial activity leveled off in the first half of the year and sagged thereafter. (3) The Federal Reserve early in 1960 began to ease credit, and subsequently carried out this policy through a broad program involving open market purchases, lower discount rates, and reductions in reserve requirements. (4) The Treasury's financial position improved significantly, permitting some retirement of Government debt. (5) After midyear, the dollar came under growing pressure in world markets and the outflow of gold increased disturbingly.

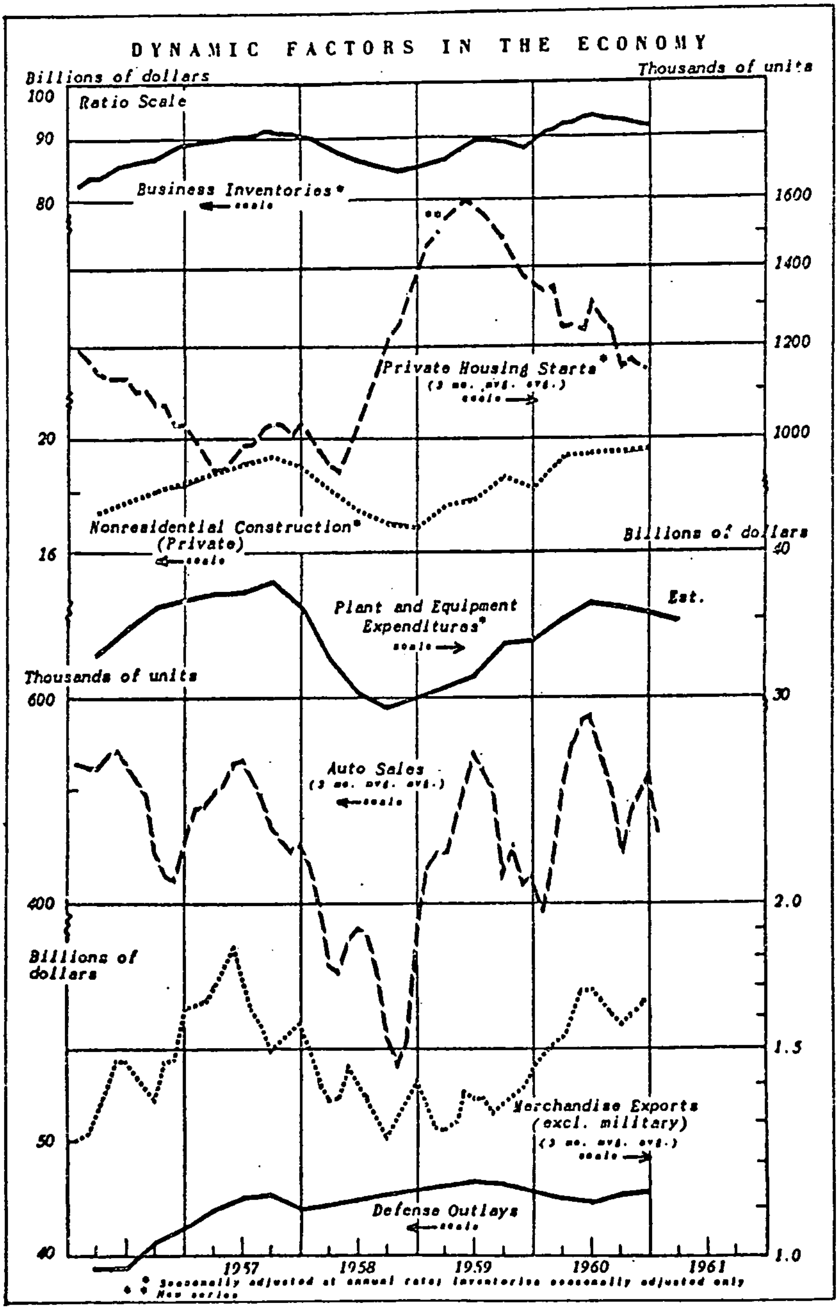
Chart 1



Contributing to the waning of inflation sentiment was the stability of the general price level. The Wholesale Price Index had been essentially flat since early 1958, and the industrial products component of this index had stopped rising in the spring of 1959; late in 1959, the Consumer Price Index had also shown signs of stabilizing. The terms of settlement of the 1959 steel strike and the prospects of a substantial improvement in the Treasury's budget position also helped assuage fears of further inflation. Finally, it was becoming increasingly apparent that the widespread abundance of industrial capacity was seriously limiting the ability of business to raise prices; this, in turn, put profit margins under pressure and undoubtedly contributed to the decline in the stock market in the greater part of 1960.

The relaxation of inflationary pressures probably facilitated the shift in Federal Reserve policy. Even before evidence of a cyclical turn became available, the Federal Reserve moved to ease credit. Moreover, as will be discussed later, the Federal Reserve used its powers to ease credit about as vigorously as it had in the recessions of 1953–54 and 1957–58.

CHART 2



The course of industrial production, the behavior of commodity and consumer prices, and the movements of the stock market—all of which are relevant to an understanding of changes in the credit markets—are shown on chart 1. Major factors in the business picture are illustrated on chart 2.

Assumptions for 1961

Underlying the current appraisal of the prospects for the credit markets this year is the assumption that the business adjustment, which has been underway since the late spring of 1960, will prove to have been fairly moderate, that economic activity is approaching the bottom of the cycle, and that signs of recovery should become apparent within the next few months.

TABLE 1.—*Recession comparisons* [1]

[Percent change during 1st 7 recession months]

	1960-61	1957-58	1953-54	1948-49
Gross national product	(2)	−4	−2	−4
Industrial production	−6	−12	−10	−7
Nonfarm employment	−2	−2	−2	−3
Unemployment	+40	+54	+100	+59
Hours worked per week, manufacturing	−4	−4	−3	−2
Manufacturers' new orders	−6	−12	−9	−12
Manufacturers' inventories	−2	−3	−1	−3
Personal income	+1	−1	−1	−3
Retail sales	−2	−6	−4	(3)
Housing starts (private nonfarm)	−25	−10	+6	+16
Industrial raw materials prices [4]	−7	−10	−5	−28

[1] Percentage changes in 1960-61 from May or 2d quarter 1960, to December or 4th quarter 1960. Percentage changes in previous recessions for comparable periods from month or quarter of National Bureau of Economic Research turning points. Based on seasonally adjusted data, except for prices.

[2] Decrease of less than 0.5 percent.

[3] Increase of less than 0.5 percent.

[4] BLS index of daily spot prices.

An important consideration, as table 1 indicates, is the mildness of the contraction so far, compared with the corresponding periods of the three earlier postwar recessions. Within this general framework, the developments likely to affect credit conditions in 1961 are projected as follows:

The liquidation of business inventories will continue at a moderate pace for another quarter or two, but will be followed by some inventory rebuilding. For the year as a whole, a small ($1–$2 billion) net liquidation is anticipated.

Business spending on plant and equipment is likely to follow a downward course during most of the year, but with the possibility of a reversal in trend in the closing months. For the year as a whole, capital outlays are expected to show a decline in the 5–10 percent range.

Privately financed housing starts and total construction expenditures are both expected to show modest increases (3–5 percent) over 1960.

Retail sales of passenger cars are projected some 10 percent below last year, with a larger share of the market accounted for by lower priced compact cars.

Living costs and prices of industrial products may rise 1–2 percent in the course of the year. However, while there may well be renewed concern over inflation, a resurgence of inflation psychology of the intensity of the 1955–57 period is not assumed here.

The Treasury is assumed to incur a cash deficit of some \$2–\$3 billion during 1961; a cash surplus of \$4½ to \$5 billion in the first half of the year will be followed by a cash deficit of \$7–\$8 billion in the second half. In its financing operations, the Treasury is expected to place major reliance upon short-term financing, but the chronic problem posed by the shortening of maturities by the passage of time will mean continuing Treasury efforts to avoid relying solely upon the use of short-term obligations.

The U.S. balance of payments, exclusive of the movements of domestic short-term funds in response to interest rates and other considerations, is likely to show another deficit in 1961.

Implications for credit conditions

While these general economic assumptions may help develop a point of view concerning the forces that are likely to be operating in the credit markets, they give no assurance that the trends in credit and interest rates can be correctly forecast or assessed. Even if all of the basic assumptions here made should prove reasonably valid, it would still be impossible to gage the reactions of the financial markets to the changing prospects in business, the budget, debt management and credit policy; nor is it possible to make proper allowance for the decisions of individuals concerning how much to save and how their savings should be invested.

Today, the outlook is further complicated by the change of administration. It is not possible at this juncture to foretell what position the new administration will take on such crucial matters as fiscal policy, debt management and the credit system. However, the President's message on economic recovery and growth clearly indicates a new position with regard to the influence that monetary policy and debt management should exercise upon the course of interest rates.

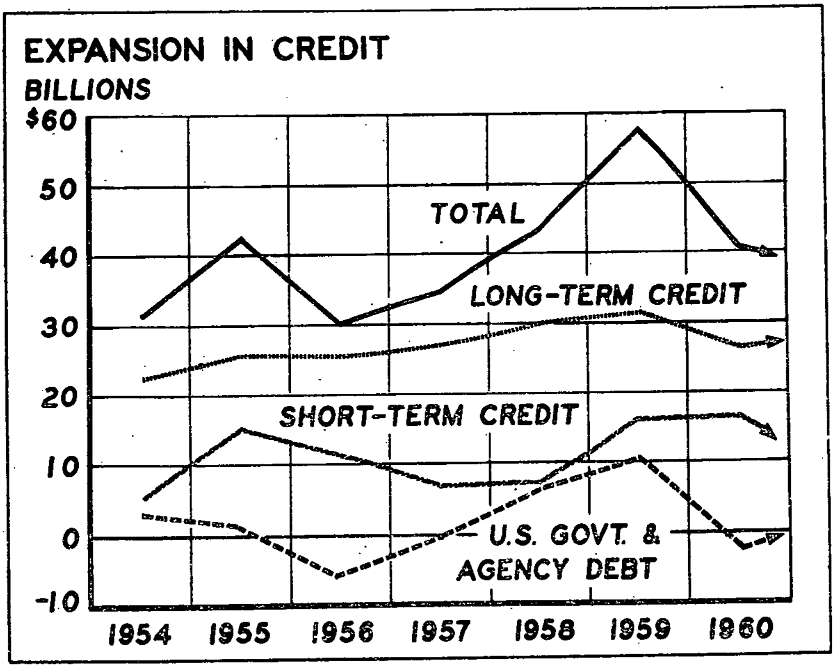
A second major imponderable in the present situation is the impact of the recent decline of world confidence in the U.S. dollar and the greater influence of the balance of payments upon the domestic economy. Developments of recent weeks have helped restore faith in the dollar and curtail speculation in gold, but it is surely clear that foreign holders of dollar balances will remain sensitive to economic developments in the United States, including the course of fiscal policy, credit policy, and wages and prices. The domestic credit markets, in turn, cannot be expected to be insensitive either to fluctuations in business and credit conditions abroad or to changes in international opinion regarding the solidity and the future of the dollar.

EXPANSION OF CREDIT

The volume of credit outstanding expands each year by a substantial amount, but the size of the increase varies from year to year in response to the business cycle, the Treasury's position and other factors. In recent years, as shown on chart 3, the annual increase in credit outstanding has ranged between about \$30 billion in 1956 and some \$58 billion in 1959.

For this analysis, the expansion of credit is classified into three major divisions: (1) long-term, consisting of real estate mortgages, State and local government obligations, and corporate securities (including foreign securities sold in the United States and net new issues of corporate stock); (2) short-term, including consumer credit, bank loans (except mortgage loans and loans to consumers—the latter already being included in consumer credit), and miscellaneous short-term instruments (including open market paper, stock market credit, net trade payables of nonincorporate business and policy loans of life insurance companies); and (3) U.S. Government and agency debt, exclusive of securities held by the Government investment accounts and the Federal Reserve.

CHART 3



Smaller credit expansion

Total credit expansion in 1960 amounted to about $41 billion, which was some 30 percent below the record volume of 1959. The major reason for this decline, as is evident from chart 3, was a swing—from a $10½ billion rise in 1959 to a reduction by some $3 billion last year—in the publicly held securities of the U.S. Government and its agencies. Also, long-term credit rose somewhat less than in the prior year, largely because of the smaller growth in mortgages. Short-term credit, however, expanded about as much as in 1959, and possibly more.

The forces at work suggest that in 1961, Government and agency debt will expand anew, that the increase in long-term credit will be as great or greater than last year. The big unknown is the short-term sector, where forecasting can be very tricky. As of today, it seems reasonable to expect short-term credit to expand considerably less than in the record years 1959 and 1960. As a result of the drop in short-term credit expansion, the expansion of total credit this year may be somewhat below 1960, but perhaps by a relatively small amount.

Goverment sector

The dramatic shift in the Government sector in 1960 reflected essentially the fact that the Treasury had been a huge borrower in the calendar year 1959 but was able to achieve a small reduction in its debt in the calendar year 1960. This improvement was a major factor in the easing of credit and the decline of short-term interest rates in 1960.

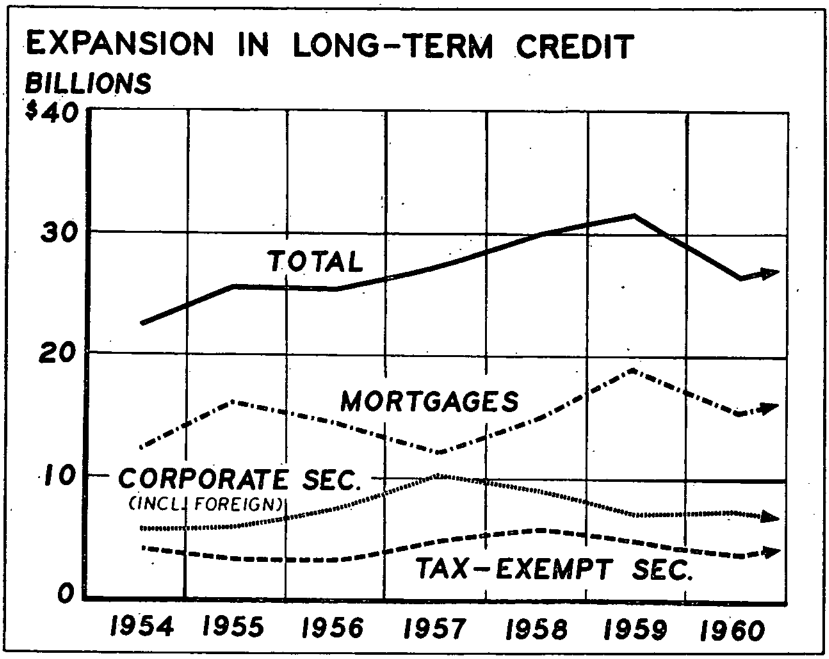
Today, however, the Federal budget outlook appears less favorable than it was a year ago. The publicly held debt of the U.S. Government and its agencies is likely to expand by an estimated $1–2 billion in 1961, which is a sharp reversal from the $3 billion reduction of last year. In the first half of the year, to be sure, the Treasury will be operating at a surplus and will thus be retiring some debt. In the latter part of 1961, however, the Treasury will be incurring a much larger deficit than in the comparable months of 1960, and will be heavily in the market for new money.

Long-term credit

In almost every year since World War II, the volume of long-term credit has increased by a larger amount than in the previous year. In 1960, however, for the first time, long-term credit expansion was significantly smaller than in the preceding year. Total long-term credit increased by about $27 billion, or 15 percent less than in 1959.

This smaller advance in long-term credit was due primarily to a slower rise in real estate mortgage debt. Private housing starts declined nearly 20 percent and mortgage recordings were off by nearly 10 percent. These developments in the course of 1960 were in striking contrast to the trend in earlier periods of economic slack, when housing starts and accordingly residential mortgages and other categories of mortgage debt as well tended to move upward against the business cycle. Contributing importantly to this variation in the behavior of mortgage debt in 1960, especially in the case of residential mortgages, is the changed housing market, as indicated by increased vacancies and sluggish sales of both old and new homes.

CHART 4



As shown on chart 4, the volume of outstanding corporate obligations in 1960 advanced by a slightly greater amount than in the preceding year. Increased new bond issues net of retirements more than offset the mild curtailment of common stock financing that accompanied the declining trend in the stock market through most of the year. On the other hand, municipal offerings declined last year; with a stepup in retirements, the result was the smallest growth in the outstanding indebtedness of State and local governments since 1956.

It seems probable that the slackening in the growth of long-term credit in 1960 will prove to be transitory and will be followed by a larger increase in the current year. This outlook is based on the assumption that both total construction expenditures and private housing starts will advance moderately in 1961. The indicated strength in commercial construction and the prospect of some rise in residential building suggest that mortgage debt will show a larger increase than in 1960.

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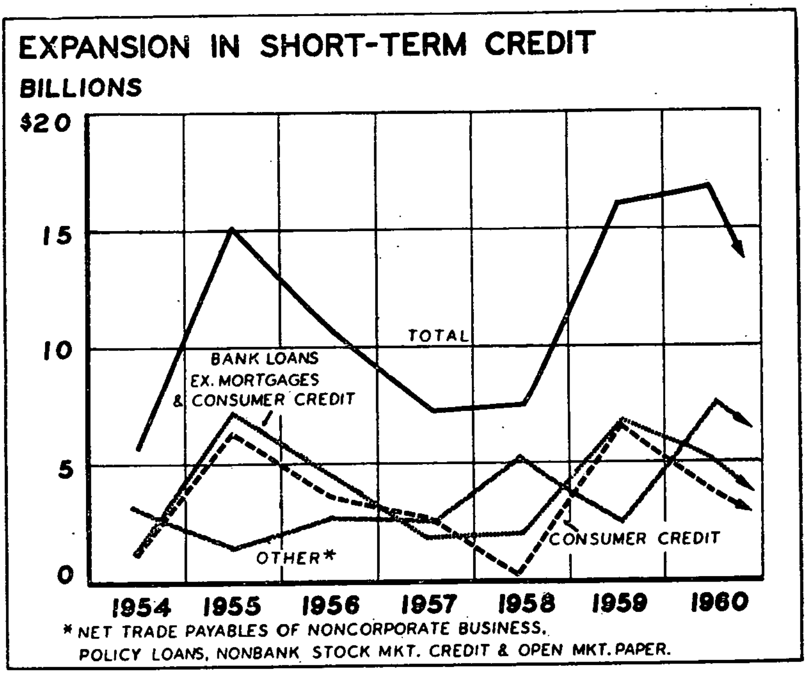
The year 1961 is expected also to bring a higher volume of new financing by State and local governments. Contracts for public works are very strong, the voters last November approved a record amount of new bond issues, and the current backlog of financing is very large. New corporate issues may drop back somewhat in the wake of lower plant and equipment expenditures, but this sag in the corporate sector may be more than offset by the prospective increases in mortgages and tax exempts.

The short-term area

Although the growth of total short-term credit often varies widely from year to year, the aggregate in 1960 was not far different from that of 1959. According to preliminary estimates, shown on chart 5, the expansion in consumer credit and bank loans (excluding mortgages and consumer loans) was less, while other types of short-term credit, such as commercial and finance company paper, net trade payables of noncorporate business, and miscellaneous classifications showed larger increases.

CHART 5



Currently, consumers are endeavoring to hold down their indebtedness, and present trends suggest that bank loans this year will also expand somewhat less than in 1960. At the same time, the growth in open-market paper and trade debt is likely to slacken considerably from the record proportions of 1960. Consequently, the expansion of short-term credit in 1961 may well be substantially below the level of the 2 previous years.

THE SUPPLY OF FUNDS

The savings institutions as a group are fairly steady suppliers of funds to the credit markets and the increases in their holdings of credit instruments usually do not fluctuate much from year to year.[1] In contrast, as shown on chart 6, funds supplied by the commercial banks, on the one hand, and the broad group known as "other investors," on the other hand, fluctuate widely in response to

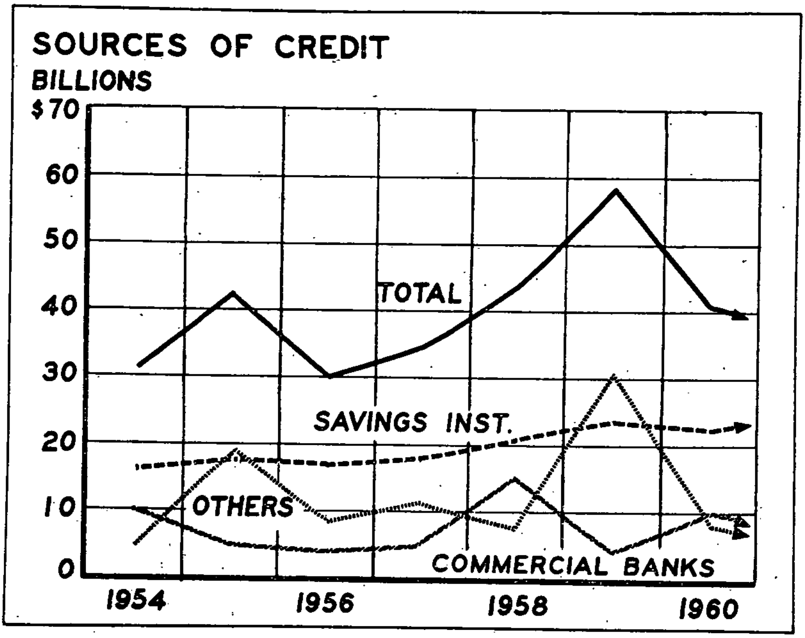
[1] Savings institutions, as here defined, include life insurance companies, mutual savings banks, savings and loan associations, fire and casualty insurance companies, corporate pension funds, State and local government retirement funds, investment companies, and credit unions.

changes in business conditions and credit policy.[2] After business activity has advanced and credit has become tight, the commercial banks generally do not expand their holdings of credit instruments importantly, where as the "other investors," attracted by higher yields, tend to enter the market in a big way. This pattern is reversed when business sags and credit eases.

Shifting sources

With credit easier, the commercial banks provided more than twice as much credit in 1960 as in 1959. In fact, the $10 billion rise in bank loans and investments last year has been exceeded only in the recession year 1958, and has been equaled only in the recession year 1954.

CHART 6



However, the most striking development in 1960 as regards the supply of funds was the sharp decline in the amount of funds provided by other investors—which as a group absorbed only about $8 billion of the total credit expansion of 1960, compared with an unprecedented $30 billion in the prior year, when yields had been substantially more attractive.

Indications are that ample credit will be available to meet the financing requirements of 1961. Individual savings and the flow of funds to savings institutions gained strength in 1960, and unless the economy experiences another buying boom or a resurgence of inflationary psychology—neither of which appears probable in the months ahead—the current favorable trend of savings is likely to continue. On the other hand, credit supplied by the commercial banks and by other investors as a group this year is expected to be less than in 1960.

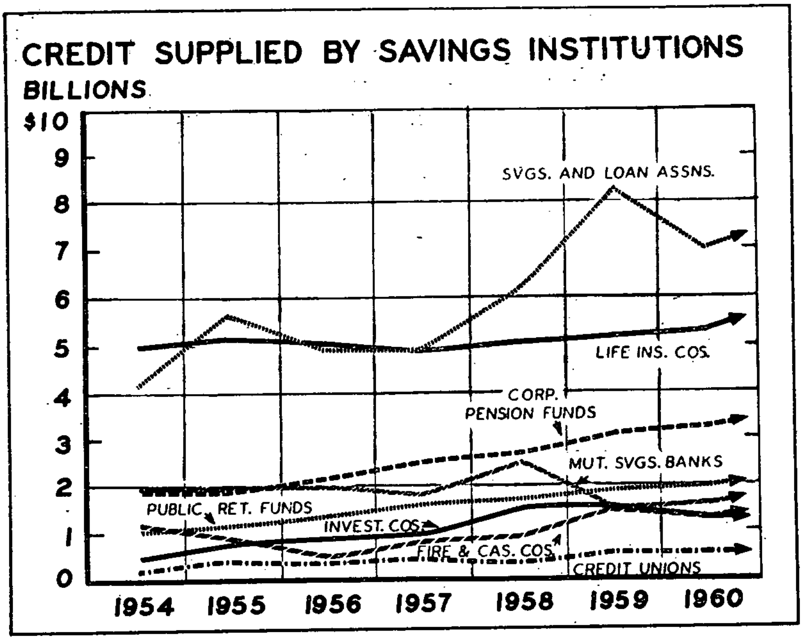
The savings institutions

The slower expansion in the amount of credit supplied by the savings institutions as a group in 1960 was contrary to the experience in previous years of slackening economic activity. However, this slowdown was due not to any reduction in the flow of savings to savings institutions, which on the contrary set new records in most cases, but instead to the fact that savings and loan

[2] The "other" category comprises business corporations, foreign investors, Federal agencies, individuals, and several miscellaneous categories.

associations used part of their savings gains to scale down their previous year's borrowings from the Federal home loan banks and to rebuild their cash. Also, with the stock market weaker, investment companies attracted a smaller amount of funds in 1960 than in 1959. Credit supplied by each major class of savings institution is shown on chart 7.

CHART 7



With individual savings likely to continue strong through most of 1961, at least, the long uptrend in the amount of funds provided by savings institutions may be expected to reassert itself. In fact, there is a reasonable prospect that total funds supplied by these institutions in 1961 may not only be materially above 1960 but may surpass by some 5 percent the previous peak year 1959. Moreover, this increase should benefit particularly the mortgage market, which is likely to be more liberally supplied with funds this year than last.

The savings and loan associations, having reduced their borrowings and rebuilt their liquidity, face what may well be a record growth in their savings capital this year; consequently, they should have considerably larger amounts available for investment in mortgages. The mutual savings banks should also provide a greater volume of funds to the market as a result of the anticipated increase in their deposits, which have been growing more rapidly since the middle of 1960.

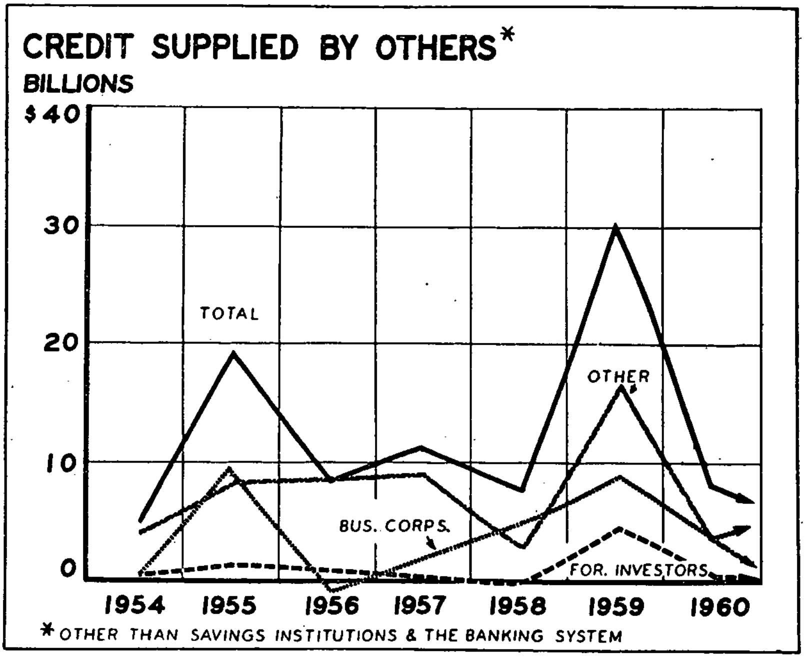
At the same time, pension funds, both of corporations and of State and local governments may be expected not only to continue their vigorous asset growth of recent years but also to raise their stake in mortgages; although these funds have not invested heavily in mortgages so far, they are gradually being attracted by the higher yields in the mortgage market. The life insurance companies may do no more than maintain the fairly stable increases in their investment holdings of recent years, but the somewhat lower volume of corporate financing in prospect this year makes it reasonable to assume that they, too, will display greater interest in mortgages in 1961.

The strong trend of savings augurs well also for the reception of the prospective rise in new security offerings of State and local governments. No difficulty is anticipated in attracting buyers, although if recent proposals to curb the tax exemption advantage now enjoyed by obligations of State and local governments receive widespread congressional support, the market for tax-exempt securities would obviously be adversely affected.

The "other" investors

The effect of lower yields upon the group classified as "other" investors was clearly demonstrated by the sharp drop in the amount of credit it furnished to the market in 1960, shown on chart 8. In the preceding year, 1959, business corporations and individuals, together with foreign investors, had greatly enlarged their holdings of credit instruments; interest rates were attractive and, in addition, business corporations were accumulating short-term Treasury securities to meet the higher tax liabilities resulting from the increased profits of that year. In 1960, these conditions were reversed; interest rates declined, corporate profits fell off, and the amount of funds supplied by the "other" investors, accordingly, shrank by about 70 percent.

CHART 8



The factors which contributed to such a drastic reduction in the takings by "other" investors in 1960 are likely to be at work again in the current year. Yields on short- and medium-term obligations continue to be relatively unattractive to individuals at home as well as to investors abroad, and business profits are being squeezed further. In short, the amount of credit supplied by "other" investors in 1961 may well be below even the greatly reduced level of the previous year.

THE COMMERCIAL BANKS

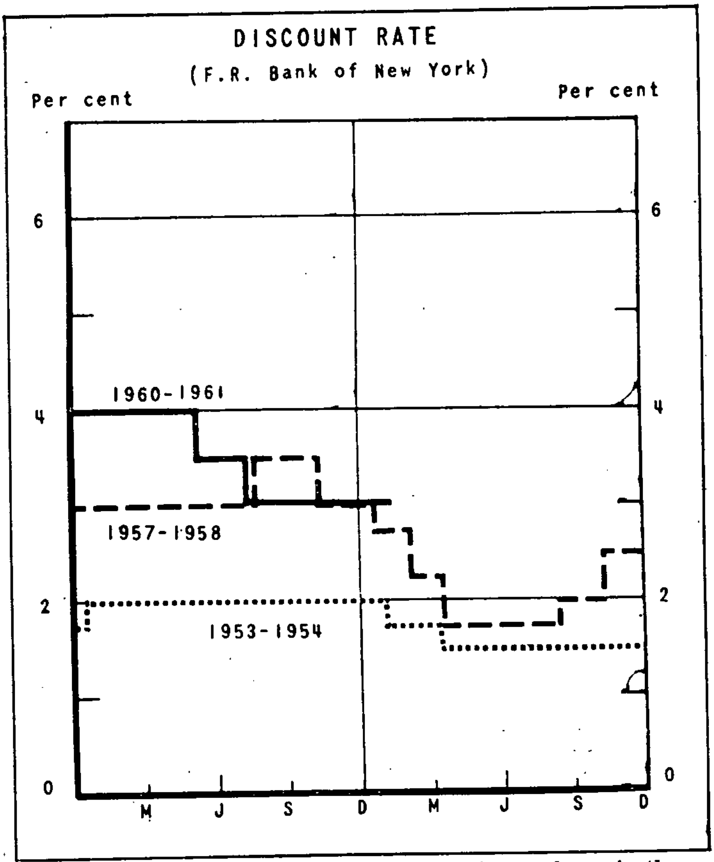
The commercial banks are perhaps the most diversified of all lending institutions, providing credit that ranges from 1-day loans to long-term financing secured by liens on real estate. The allocation of their assets varies with changes in business activity, demands for loans, the course of interest rates, and the fluctuating evaluation of the future. The total amount of credit furnished by the banks—that is to say, the total of loans and investments combined—is determined, however, essentialy by credit policy, which results in a greater or lesser volume of reserves being supplied to, or withdrawn from, the banking system.

The easing of credit

The Federal Reserve began to ease credit early in 1960, well before evidence of a "topping off" in the economy had become available. With business sentiment turning increasingly cautious and expectations of a renewed boom in prices rapidly waning, the credit authorities found it possible to relax credit conditions without running much risk of rekindling the fires of inflation. The successful avoidance of a full-fledged boom thus attested to the good timing and efficacy of the Federal Reserve countercyclical credit policy.

Beginning early in 1960, open market operations provided substantial reserves to the banking system. Later, moreover, reserve requirements were reduced and the regulations governing vault cash were revised so as to free large additional reserves. Also, the discount rate, shown on chart 9, was reduced twice—first in June and again in August.

CHART 9



The Federal Reserve eased credit last year as vigorously as in the recession periods of 1953–54 and 1957–58. This is evident from the behavior of two of the most sensitive measures of conditions in the credit markets; namely, the volume of member bank borrowings and the reserve position of member banks. As shown on chart 10, member bank borrowings dropped steadily in 1960 and by yearend were down to the extreme lows of the 1954 and 1958 recessions. By the same token, the reserve positions of member banks, shown on chart 11, im-

Chart 10

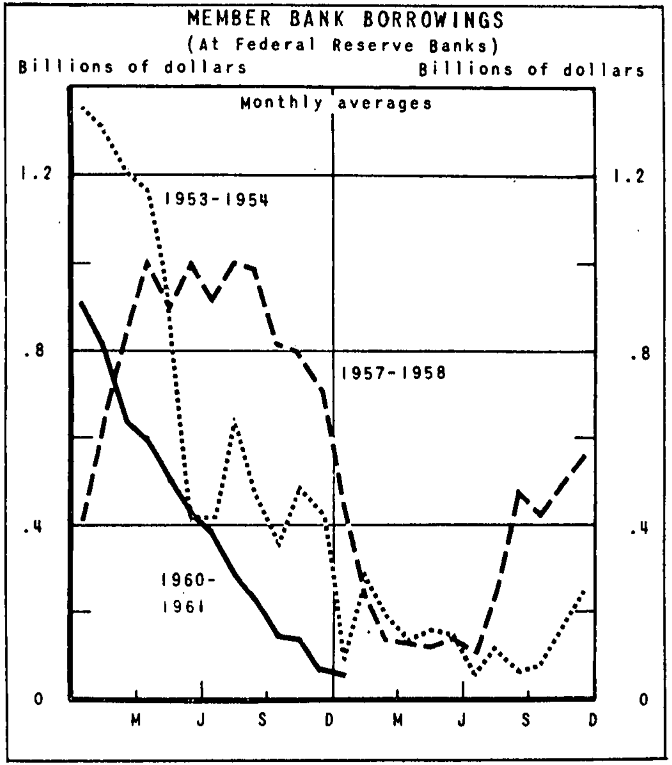
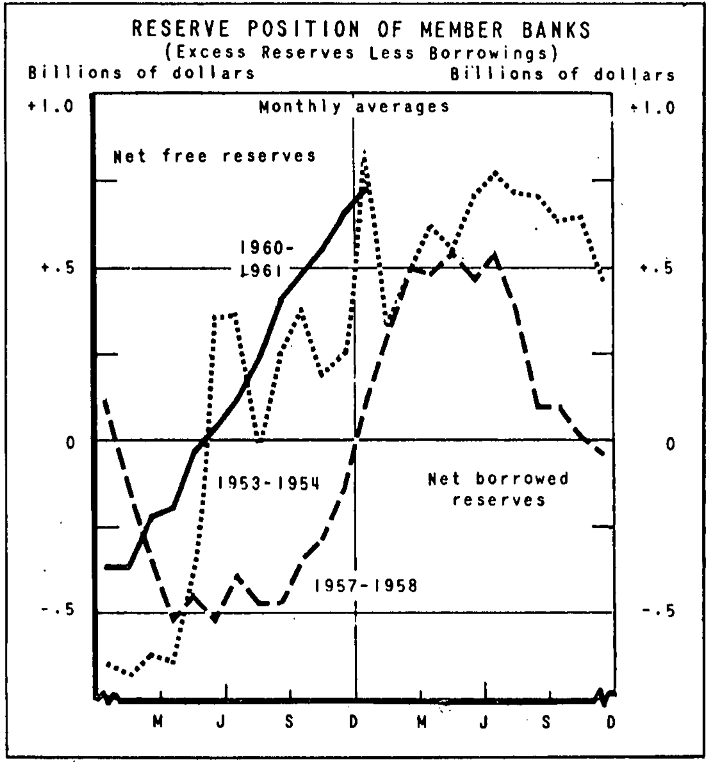


Chart 11

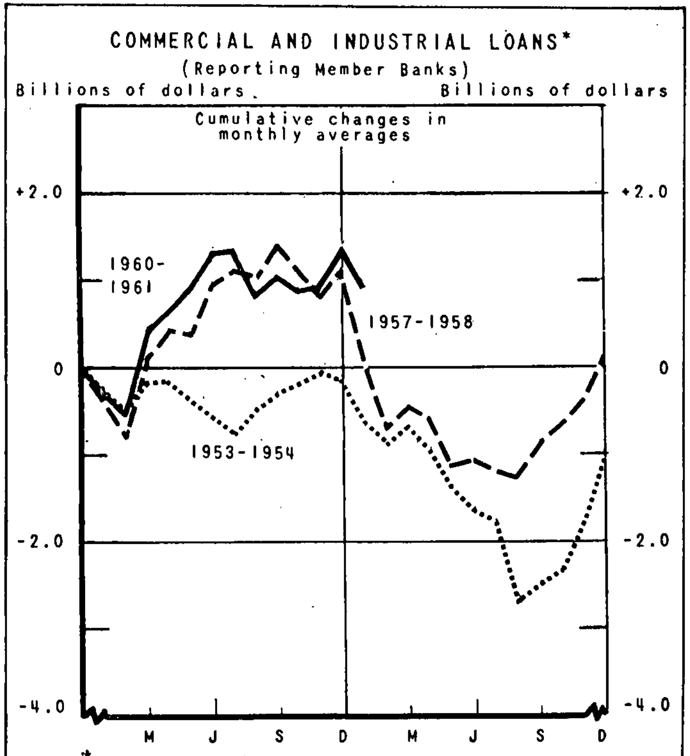


proved rapidly last year; net borrowed reserves were completely eliminated before midyear and, by the end of 1960, net free reserves were averaging substantially higher than in 1958 and were approaching the peaks reached during the 1954 recession.

Response of the banks

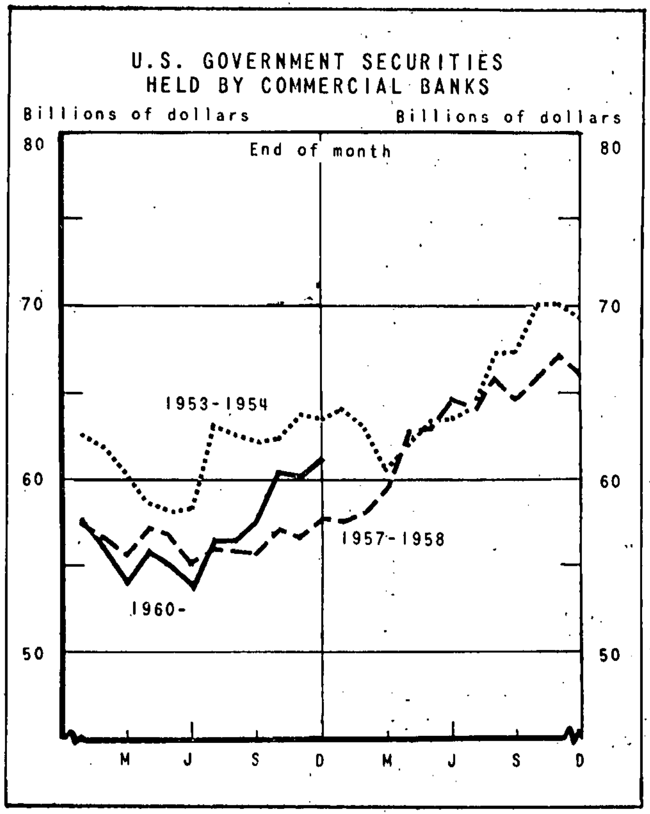
The commercial banks met heavy demands for business loans in the first half of 1960, as shown on chart 12; this reflected the rebuilding of strike-depleted inventories as well as large tax borrowings. Around the middle of the year, however, business loans leveled out, similarly to their behavior in 1957.

CHART 12



*Includes agricultural loans in 1953-54 and 1957-58.

CHART 13



The commercial banks responded to the weakening of loan demands and the easing of reserve positions by stepping up sharply their holdings of Government securities, as shown on chart 13, and this led to an accelerated growth of commercial bank deposits in the second half of 1960.

Deposit expansion last year was substantially larger than in the comparable periods of 1957–58 and 1953–54, as is apparent from chart 14. Since most of the increase in bank deposits last year was reflected in higher time rather than demand deposits, the so-called active money supply (demand deposits adjusted and currency outside banks) last year did not begin to expand until later in the year. This, however, is not unusual; chart 15 indicates that in previous recessions, too, the money supply did not react instantly to credit easing. Also, the rise in the active money supply in the second half of 1960 appears to have been at least as vigorous as in the early stages of previous business declines.

CHART 14

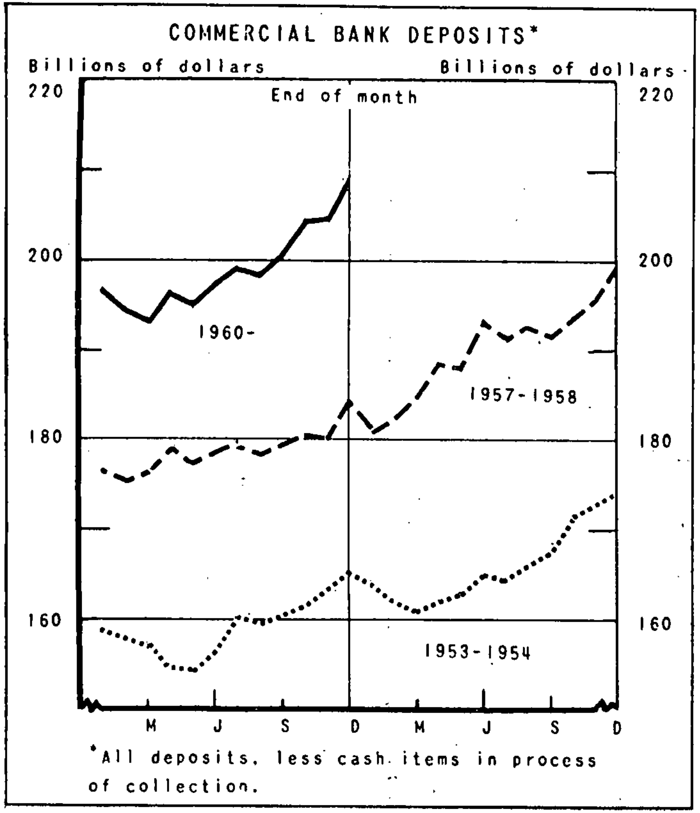
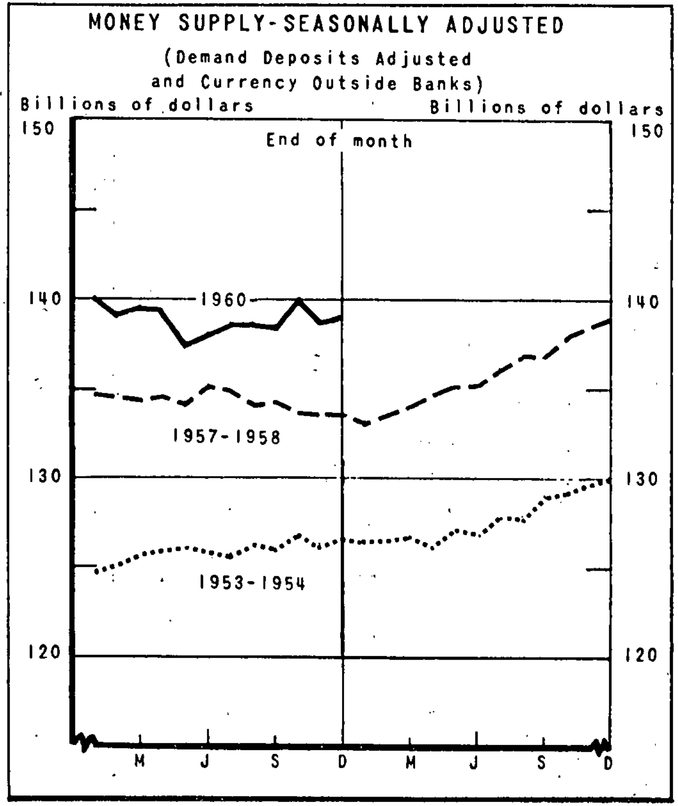
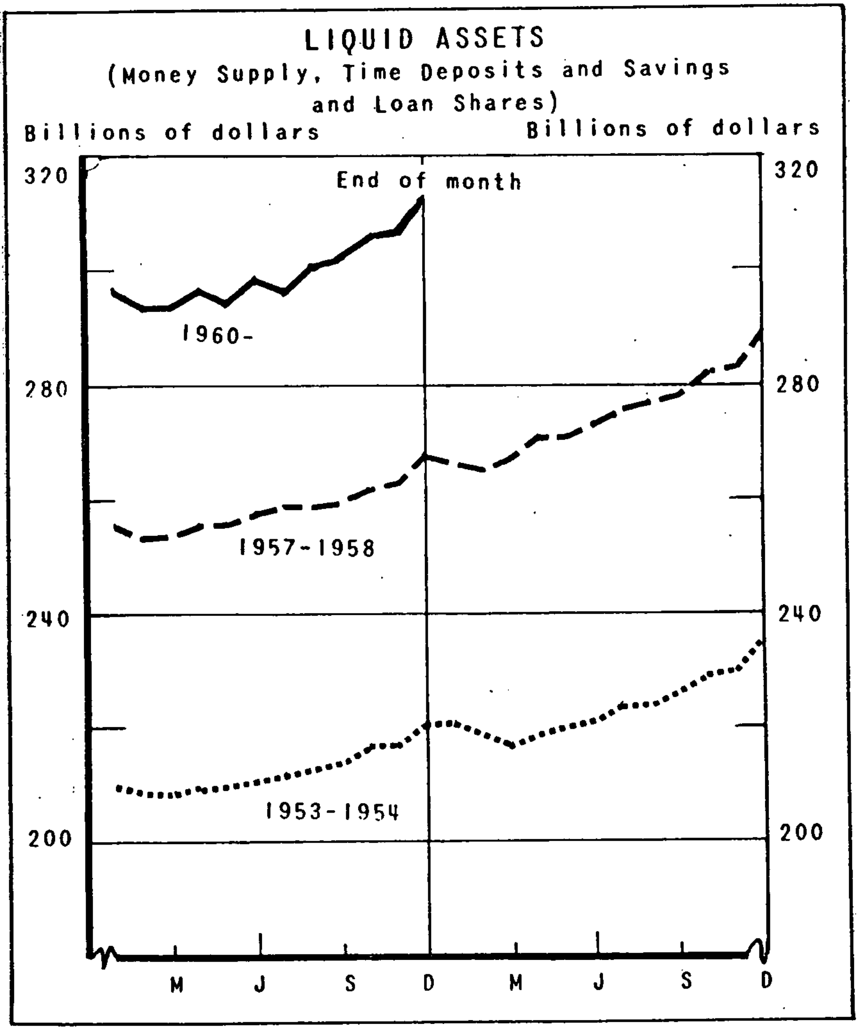


CHART 15



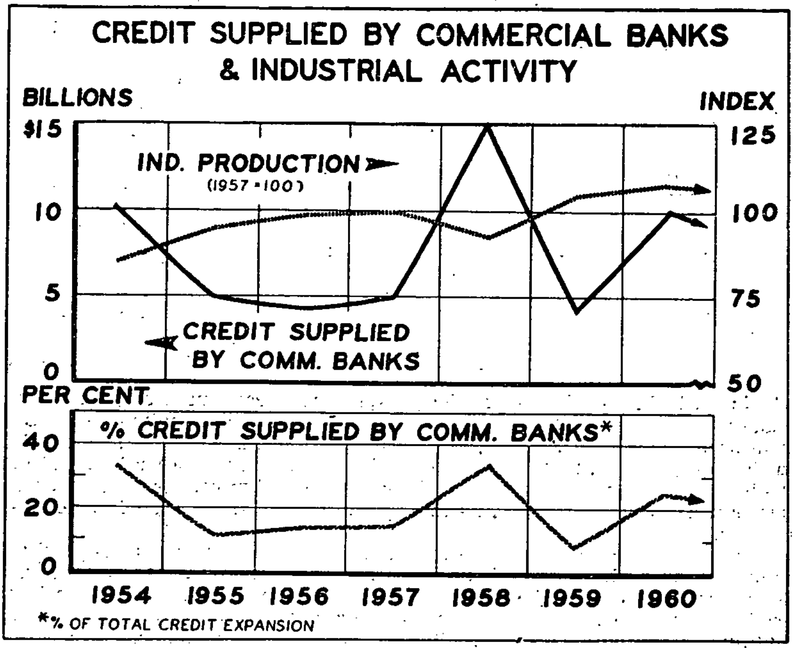
Measured in terms of liquid assets, furthermore, the reaction to credit ease was more immediate and was exceptionally strong. Such assets—which comprise not only the active money supply but also time and savings deposits and the shares of savings and loan associations—have not only been expanding at a brisk pace since the middle of last year, as chart 16 makes clear, but have been moving ahead faster than in the previous two recessions.

CHART 16



It is evident that the business downturn that developed in the second quarter of 1960 cannot be attributed to a shortage of bank credit or to tightness in the credit markets. Last year was the first, at least in recent history, in which the Federal Reserve promoted a large expansion in commercial bank credit at a time when the economy was still operating at or near record levels; industrial activity in 1960 averaged 3 percent above 1959. However, as a result of credit policy, the total loans and investments of the commercial banks increased by some $10 billion in 1960 to supply about one-fourth of the total credit expansion in the year. This increase, shown on chart 17, was almost 2½ times as large as the expansion in the previous year and was exceeded only by the $15 billion in 1958.

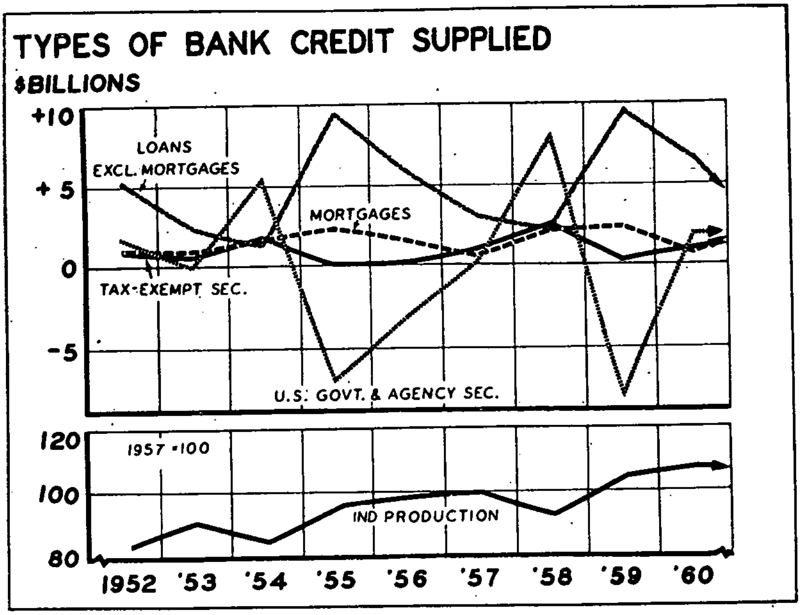
CHART 17



Bank credit in 1961

Chart 18 shows how the amount of bank credit extended usually changes significantly with fluctuations in economic activity. The decline in loan demands last year reflected the shift to liquidation of business inventories; the slowdown in plant and equipment expenditures, the slackening of consumer credit growth, and the drop in homebuilding. Aslo, the finance companies reduced their bank loans and resorted to greatly increased issues of open-market paper. With inventories likely to be liquidated further in 1961, plant and equipment spending reduced and consumer credit probably leveling out, increases in most type of loans may be even smaller in 1961 than in 1960.

CHART 18



This outlook, together with the prospect of a continued easy credit policy, suggests that the commercial banks will again add to their holding of Government securities in 1961. Last year, these additions amounted to about $2 billion. In the current year, they may be somewhat less. On the other hand, the banks are likely to add more actively to their holdings of mortgages and of State and local government obligations, as they usually do in the wake of lower business activity.

These considerations indicate that the business recovery is not likely to be hampered by a shortage of bank credit. The commercial banks have reduced their borrowings from the Federal Reserve to a nominal level, their liquidity has been improved, and the decline in their loan-deposit ratios will presumably continue in the months ahead. As a result, creditworthy borrowers should be able to satisfy their requirements for bank financing without difficulty in 1961.

INTEREST RATES

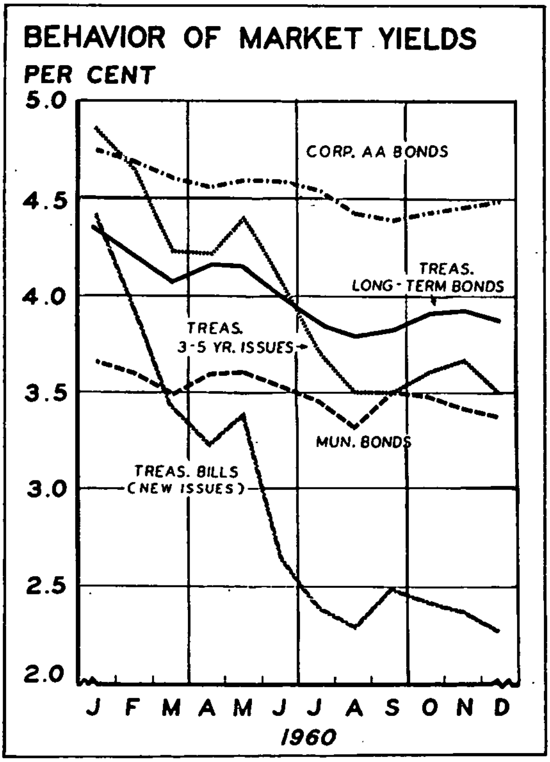
The cyclical rise in interest rates that followed the upturn in business activity in 1958 came to an end around the start of 1960, and all classes of interest rates declined markedly last year. Table 2 shows the extent of the cyclical rise in interests rates in 1958–59 and the decline last year.

TABLE 2.—*Interest rates and bond yields*

[Monthly averages, percent per annum]

	June 1958	December 1959	December 1960	Change from— June 1958 to December 1959	Change from— December 1959 to December 1960
Government securities:					
Bills (new 3-month issues)	0.88	4.57	2.27	+3.69	−2.30
9- to 12-month issues (other than bills)	.98	4.98	2.79	+4.00	−2.19
Long-term bonds	3.19	4.27	3.88	+1.08	−.39
Discount rate (New York Federal Reserve Bank)	1.75	4.00	3.00	+2.25	−1.00
Commercial paper (4 to 6 months)	1.54	4.88	3.23	+3.34	−1.65
Corporate bonds:					
Outstanding (Moody's Aaa)	3.57	4.58	4.35	+1.01	−.23
Outstanding (Moody's Baa)	4.55	5.28	5.10	+.73	−.18
New utility issues (BT Co, grade 2)	3.94	5.28	4.94	+1.34	−.34
Municipal bonds (Standard & Poor's high grade)	3.26	4.05	3.45	+.79	−.60
Calculated yields on FHA-insured mortgages	5.37	6.23	6.04	+.86	−.19
Bank loans:					
Prime commercial lending rate	3.50	5.00	4.50	+1.50	−.50
Average rate on short-term bank loans to business, 19 large cities	4.17	5.36	4.99	+1.19	−.37
Dividend yield on common stock (200 stocks, Moody's)	4.15	3.28	3.49	−.87	+.21

CHART 19



As is usual when credit turns easy and the pace of business slows, money market rates fell off much more steeply than bond yields. Most of this adjustment of rates and yields, however, was completed by the third quarter; since the late summer, most interest rates have fluctuated in response to market forces but, as chart 19 illustrates, they have shown no obvious cyclical movement.

Chart 20

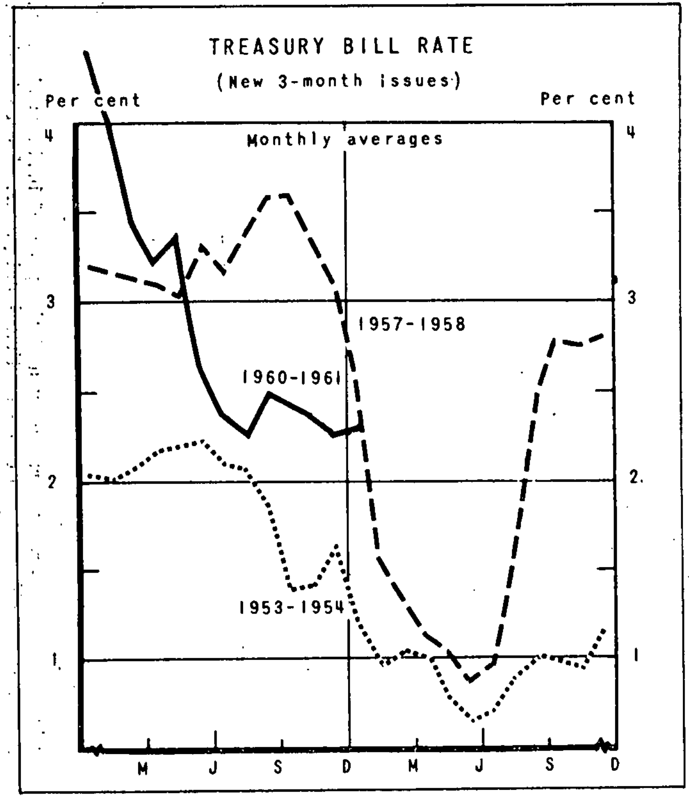
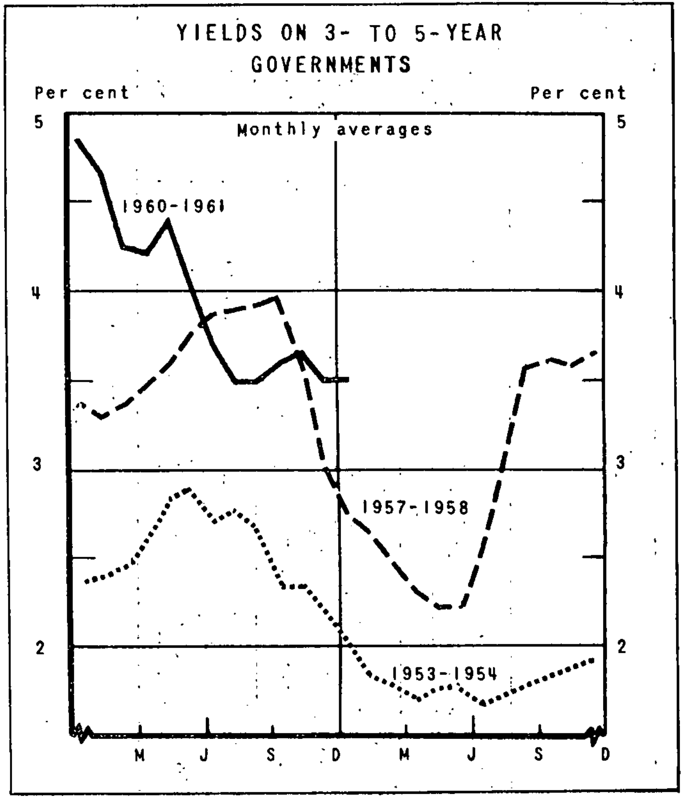


Chart 21



The recent decline

The downtrend in interest rates in 1960 was relatively smaller than in the comparable periods of the previous economic recessions. Also, while the Treasury bill rate, shown on chart 20, and the yield on 3- to 5-year Government securities, shown on chart 21, have both dropped substantially, these and other classes of interest rates have all remained considerably above the lows of the two previous recessions.

The prime commercial lending rate declined from 5 to 4½ percent last August, which was distinctly sooner than in the previous recessions. As shown on chart 22, the decline was greater, both relatively and absolutely, than in 1953–54, but less, so far, than in the sharp business recession of 1957–58. The easing of corporate bond yields, finally, has been fairly moderate to date, and less pronounced than in other periods of easy credit, as illustrated on chart 23.

CHART 22

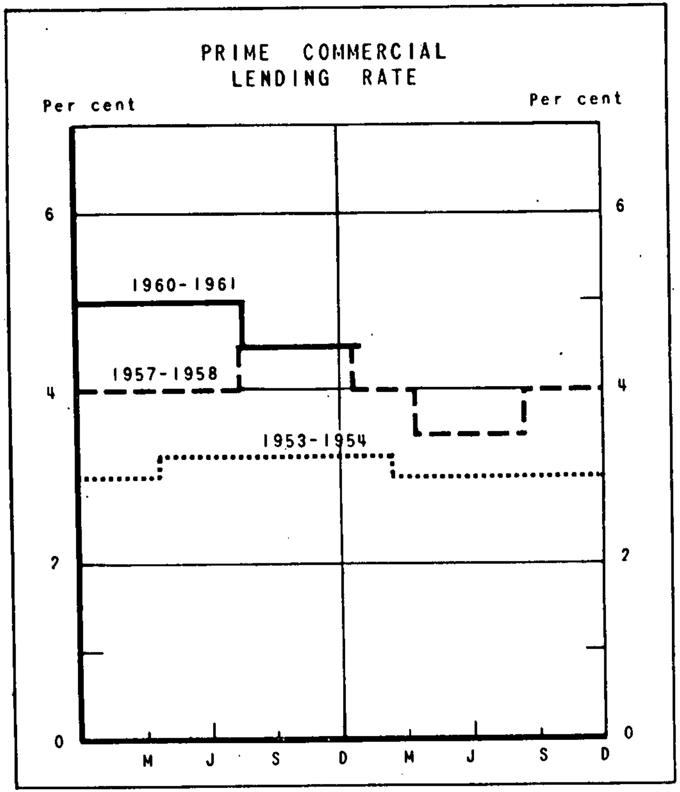
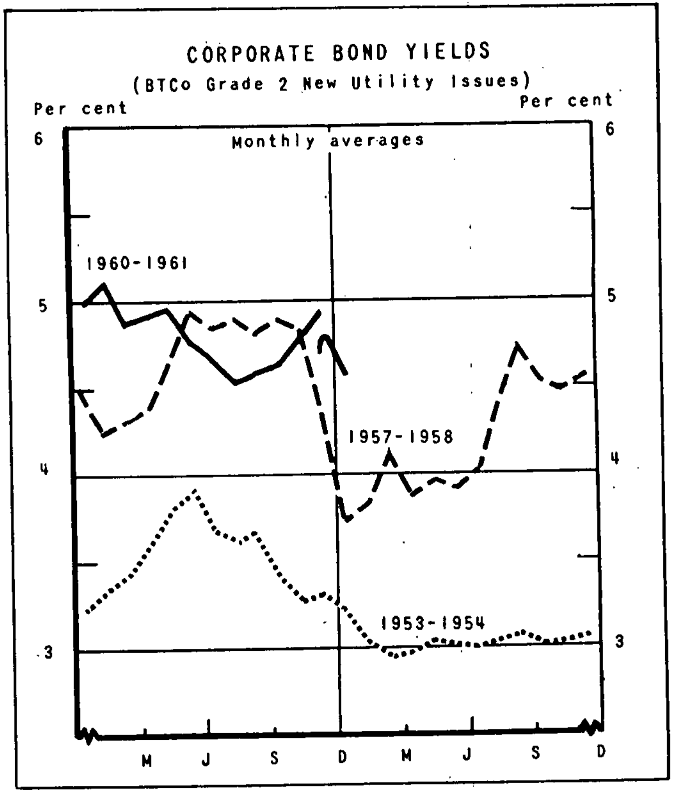


CHART 23



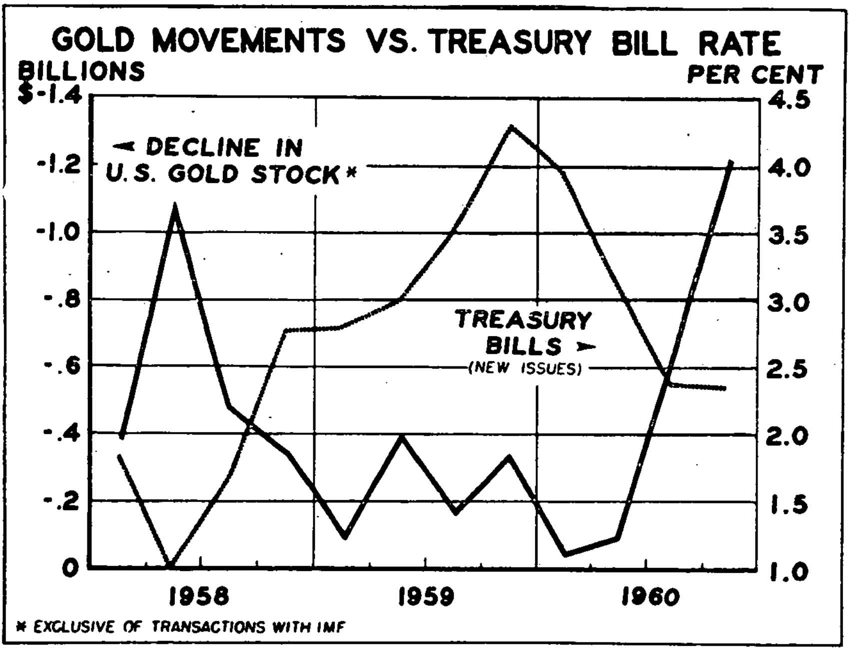
The recent behavior of interest rates is explained in part by the mildness of the easing in economic activity in 1960 compared with the sharper pace of the earlier recessions. In addition, special factors have been at work both in the bond markets and in the field of short-term rates.

The "stickiness" last year in corporate bond yields, in particular, probably reflected partly the higher volume of corporate bond financing in 1960 as against 1959. Even though the volume of new mortgage financing declined, investment managers appear to have met with no important difficulties in finding outlets for their funds at fairly small concessions in interest rates. Moreover, portfolio managers have been mindful of their experience during previous recessions, when demand for investment funds remained substantial and actually advanced to new peaks in the subsequent recoveries. Hence, they have been reluctant to enter into commitments at rates which may prove significantly below the market by the time the agreements are to be honored.

The gold outflow

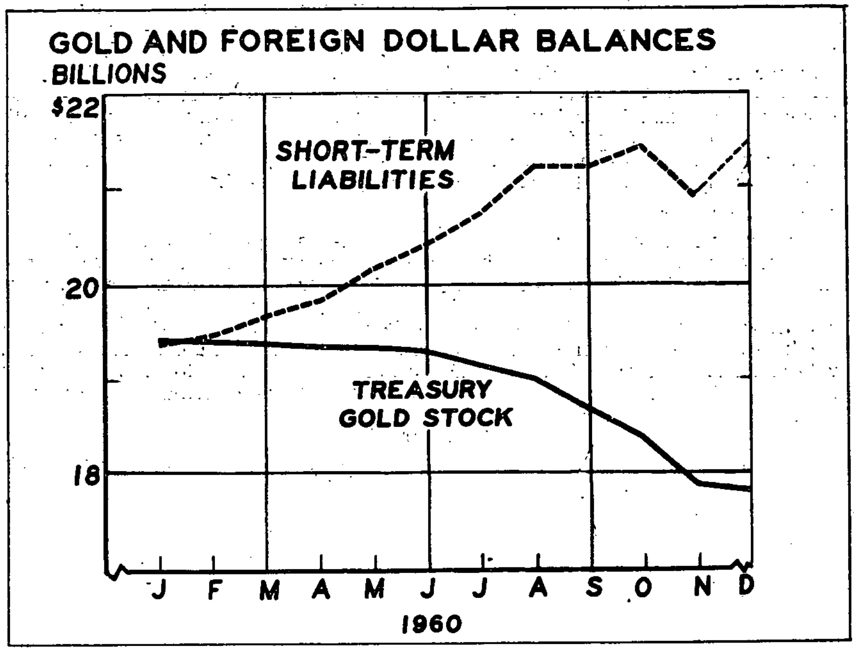
Important in restraining the decline in short-term rates in 1960 was the substantial outflow of funds from the American money market to foreign centers in response to the wide gap between yields at home and abroad. The outward movement last year, particularly of short-term funds in quest of better yields elsewhere, added materially to the total deficit in the balance of payments, the weakness of the dollar in world markets, and the outflow of gold. The strategic role of short-term rates in this situation is aptly illustrated by chart 24, which makes it evident that declines in short-term rates have contributed importantly

CHART 24



to the losses of gold in recent years. In addition, as shown on chart 25, foreigners recently seem to have been more reluctant to continue accumulating short-term dollar balances.

CHART 25

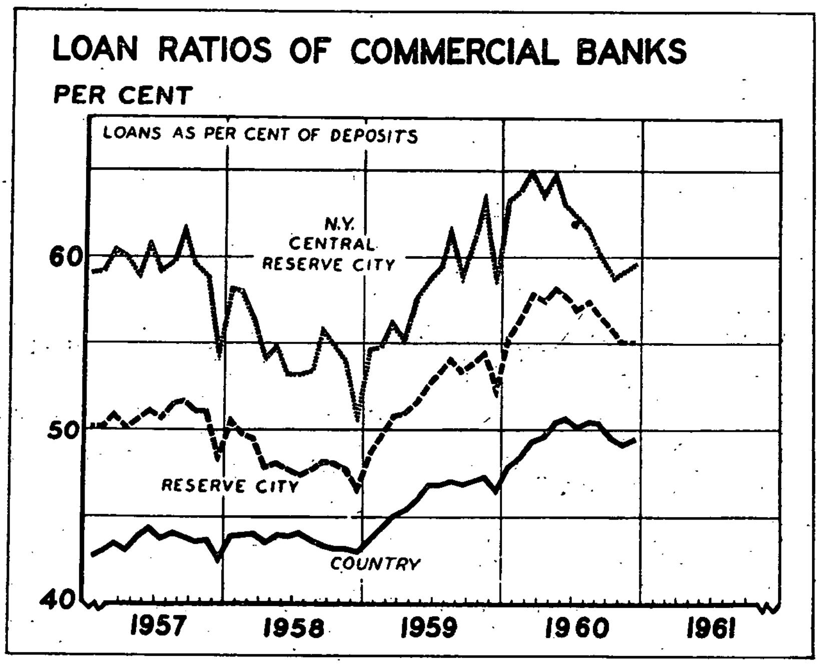


These developments undoubtedly affected the activities of the Federal Reserve in the latter months of 1960. Although the credit authorities continued their policy of easing credit, they made greater use of policy instruments tending to have less direct and immediate repercussions upon money market rates. Specifically, they resorted to reductions in member bank reserve requirements and availed themselves of the provisions of legislation enacted in 1959 to allow all vault cash to be counted as reserves.

Bank lending rates

Bank lending rates moved downward at an exceptionally early stage of the cyclical easing of business and credit but, in conformity with the usual pattern, declined less than short-term rates in the open market. The continued uptrend in the operating costs of commercial banks was presumably a factor. More important, however, was that loan ratios in 1960, as shown on chart 26, remained near or even above the peaks reached in 1959, when business was strong and bank loans soared.

CHART 26



The rapid advance in the ratio of loans to deposits in the last several years had compelled commercial banks, especially those in larger cities, to reduce their Government security holdings, frequently at a loss, in order to meet pressing loan demands. Consequently, commercial bankers have generally welcomed the recent easing of pressures for loans as an opportunity to rebuild their liquidity and to prepare for the increased loan demands that are certain to arise when the economy moves ahead once again.

Interest rates in 1961

The increased flow of savings and the currently reduced level of economic activity make it reasonable to expect some further easing of bond yields in the months immediately ahead. Short-term rates, however, are not likely to be affected significantly by these downward pressures in view of the demonstrated pull of foreign money markets and the importance of balance of payments considerations for Federal Reserve policy.

Moreover, with the economy apparently approaching the bottom of the current contraction, the next few months may well bring signs of an upturn in business and in credit demands. These, together with the large Treasury borrowings already in sight for the second half of the year, suggest that later in 1961 underlying economic forces may well be pointing toward higher interest rates. In fact, it may be pertinent today to recall the experience of 1958–59, when a large Treasury deficit compounded the rising credit needs of a business recovery and thus greatly enhanced the upward pressures on interest rates.

In the present situation, however, a new factor has been injected into the outlook for interest rates by the administration's aim to bring about, in essence, a lowering of long-term rates without adding to the pressures on the dollar. This raises a number of questions and problems which merit further consideration.

NEW QUESTIONS FOR POLICY

On February 2, in his message on economic recovery and growth, the President endorsed a program to attract more funds into the capital markets at lower yields and at the same time to halt further declines in short-term rates in order to curtail the outflow of gold. The inconsistency of these objectives was acknowledged by the President:

"In these circumstances, monetary policy and debt management must serve two apparently contradictory objectives: checking declines in the short-term rates that directly affect the balance of payments, and increasing the flow of credit into the capital markets at declining long-term rates of interest to promote domestic recovery."

Some general observations

Measures along these lines have already been initiated, including a reduction in the maximum permissible interest rate on FHA insured loans from 5¾ to 5½ percent and changes in the operation of the Federal National Mortgage Association in the secondary mortgage market. Also, the President, in his message on the balance of payments, recommended paying higher interest rates on special certificates issued to foreign governments and monetary authorities, as well as an increase in the statutory ceiling on certain foreign time deposits of commercial banks.

By and large, however, the means for attaining the President's objectives have not been described. Presumably they would involve, on the one hand, Federal Reserve purchases of longer term Government obligations to reduce bond yields and, on the other hand, sales of shorter term Treasury securities to prevent money market yields from falling. In turn, the Treasury would probably be expected to cooperate through relying upon the issuance of short-term securities.

Essentially, this program is based on two implicit assumptions which under present conditions appear to be of questionable validity. The first is that it is possible to attract larger amounts of funds into mortgages and investment securities by reducing rather than raising yields. The second is that the difference between long- and short-term interest rates can be narrowed significantly by exerting downward pressure on the long-term rate without thereby encouraging shifts of funds from the long-term into the short-term market.

Consequently, the feasibility of this program has already been the subject of sketpticism in market circles. Admittedly, to the extent that Federal Reserve purchases of Government bonds induce a shift into mortgages and other long-term investments, a major objective of the program would be met. However, there is the real possibility that many investors, instead of reaching for lower long-term yields, may prefer instead to place new funds into short-term securities, where price risks are smaller, in order to await the return of more favorable yields on long maturities. This would tend to divert funds from the investment markets and would add to the downward pressures on short-term rates—both results would be directly contrary to the desired objectives.

The many hazards and complexities involved in this program thus place heavy additional responsibilities upon both the Federal Reserve and the Treasury is constructive results are to be achieved. The chances for a successful reconciliation of the conflicting aims of the President's program would be increased if Federal Reserve purchases of longer term Government securities were to be undertaken at times when reserves would ordinarily be provided for credit policy reasons and thus would be substitutes for purchases of Treasury bills. Also, it should be understood that the program is not designed to interfere with flexible credit policy or achieve any particular level of long-term yields. Above all, it should be made unmistakably clear to the market that this is not the first step in a return to pegged interest rates—a prospect which would open the gates to inflationary psychology at home and to renewed attacks on the dollar from abroad.

A feasible alternative

It should be possible, moreover, to achieve the general goals of the administration's program by appropriate Federal Reserve and Treasury action without resort to new measures which are fraught with many hazards in principle and likely to be of relatively minor efficacy in practice. Until a business upturn is in sight, the Federal Reserve faces the task of following policies conducive to recovery without contributing to a further outflow of short-term funds, and hence of gold, to the higher yielding money markets abroad. The task is delicate but, in the current environment, it is not insuperable, since the Federal Reserve could permit short-term rates to stiffen somewhat without adversely affecting the business situation. A corollary prerequisite, of course, is that the Federal Reserve does not, at the same time, attempt to force long-term yields to artificially low levels, that is, to levels below what investors expect will prevail some months in the future.

A moderate rise in short-term rates at home would reduce the attraction of foreign money centers. Bank lending rates, however, would not be likely to be raised as a result, nor would such an increase in short-term rates, under present conditions, divert funds from the long-term markets. Furthermore, such a rise in short-term rates need not prevent the Federal Reserve from augmenting the lending power of the commercial banks if the Treasury, in turn, employs debt management policies that complement the aims of the Federal Reserve.

The Treasury already faces a chronic problem in the continuing shortening of its debt with the passage of time. At the end of 1960, for example, Treasury marketable debt maturing within 1 year totaled about $74 billion, which comprised 39 percent of all marketable securities. More striking and probably more troublesome is the fact that at the end of last year some $146 billion, or about 77 percent of the marketable debt, matured within 5 years—a higher amount than at the end of any previous year.

Added emphasis on the use of short-term securities would further unbalance the maturity structure of the debt and create increasingly difficult refinancing problems for the not-too-distant future. Financing through long-term bonds, on the other hand, would be criticized as diverting funds from other investment markets at a time when the economy is sagging. A way out of this dilemma may be found by issuing Treasury securities in the maturity range suitable for commercial bank investment. Such a Treasury policy, complementing the policy of the Federal Reserve, would lead to higher deposits, improve loan-deposit ratios, and increase the lending capacity of the commercial banks, without depressing money market rates.

A final thought

The strength of the dollar remains the most important single problem in the monetary field, and goes beyond the matter of interest rates alone. There is some basis for hope that we have seen the worst of the current wave of skepticism: foreigners appear to have gained some assurance from the developments of recent weeks. Ultimately, however, confidence in the dollar can be maintained only if the deficit in our international accounts is eliminated or at least reduced very substantially and if, moreover, we follow domestic policies and practices—in such matters as wages, prices, the budget, debt management and credit—that will stop the persistent erosion of the purchasing power of the dollar and enhance our position in a highly competitive world.

If we wish to maintain the integrity of the dollar, and if we desire to remain free to use fiscal and credit policies as tools for economic stabilization and growth, we must take to heart President Kennedy's recent words: "We cannot afford unsound wage and price movements which push up costs, weaken our international competitive position, restrict job opportunities, and jeopardize the health of our domestic economy."

The CHAIRMAN. Thank you, sir.

Our next witness, on outlook for agriculture, is Mr. George Brandow, College of Agriculture, Pennsylvania State University, University Park, Pa.

We shall be glad to hear from you, sir.

STATEMENT OF GEORGE BRANDOW, COLLEGE OF AGRICULTURE, PENNSYLVANIA STATE UNIVERSITY, UNIVERSITY PARK, PA.

OUTLOOK FOR AGRICULTURE

Mr. BRANDOW. Two major uncertainties obscure the outlook for agriculture in 1961. The first is the weather. Though agriculture is less vulnerable to weather than it used to be, it is by no means weatherproof.

The second is the possibility of important changes in Government programs for agriculture.

Having no basis for predicting what course either will take, I shall assume that the weather will be no more peculiar than usual and that farm programs now in effect will not be materially changed this year.

If the two major uncertainties are put aside, agriculture in 1961 looks a great deal like agriculture in 1960.

The realized net income of farm operators has averaged $11.6 billion annually during the past 7 years, the year 1958 omitted, and has not varied more than 5 percent from that average. Net income in 1961 is likely to be within the same range.

Unless the current slack in business activity grows into a more serious recession than experienced in the postwar period, demand for food is likely to be well sustained.

The one year of the past seven when farm income was significantly above the average for the period was 1958, and in that year unemployment hit its postwar peak.

COMMODITY PROSPECTS

Grains: Feed grain supplies have risen each year since 1952, and on the assumption of no change in programs and average weather, they are likely to increase again when 1961 crops are harvested.

Under present legislation, price supports in the next crop year will be virtually the same as at present.

Actual prices of corn dropped below support levels at harvest time last fall and are likely to repeat the performance next fall if the crop is good.

Seedings of winter wheat and the present good condition of the crop indicate that wheat production in 1961 probably will be nearly as high as in 1960 and again in excess of utilization. Wheat prices will stay about the same.

Cotton: Stocks of cotton, though still rather large, have been reduced by about half in the past 4 years, and acreage allotments have been increased for the 1961 crop.

With average weather, production should be slightly higher, but approximately in line with domestic consumption and exports.

The dual price arrangement in effect for growers in the last 2 years will be discontinued, and if 1961 supports are put at the bottom of the permissible range, farmers' average return per pound will drop slightly.

Meat animals: The well-defined cattle cycle is now at the stage where numbers on farms are high and marketings are rising, but reduction of herds has not yet begun.

Prices are expected to be down again in 1961, but not drastically so unless dry weather drives cattle off the ranges.

Hog numbers, which display a short, irregular cycle, are currently low. The spring pig crop is expected to be up by 5 percent this year, and marketings will rise next fall.

Average price of hogs in 1961 may be slightly below the average for 1960.

Sheep and lamb prices are also expected to be lower.

Poultry products: Egg production is currently running below last year, but soon after the middle of 1961 should begin to exceed the previous year's mark. On the average, egg prices will be lower in 1961 than in 1960, especially in the last 4 or 5 months. Broiler and turkey production will expand, and prices will be lower.

Dairy products: Milk production is expected to increase in 1961 by at least as much as commercial markets expand. By a special law, support prices for manufacturing milk and butterfat were increased 5 percent last September. Though actual prices were little affected at the time, higher supports may help to make the average farm price of milk in 1961 a little higher than the 1960 price.

Gross and net income: Current prospects are that farmers' cash receipts from marketings will advance 1 or 2 percent in 1961. Slackness in industry may keep the prices of things farmers buy for production purposes from rising, and part of the modest increase in cash receipts may be retained as net income.

The expected increase in net income is less than 5 percent, but even under the simplifying assumptions I have used, this estimate cannot be precise enough to pinpoint so small a change.

Contrary to the 1960 experience, seasonally adjusted net income is likely to be lower in the last half of the year than in the first half.

Exports and stocks: The total value of agricultural exports in 1961 seems likely to hold the high level reached in 1960. Cotton exports may be down slightly, but exports of fat, oils, and soybeans may be larger.

In 1960, about 30 percent of agricultural exports were nondollar sales under Public Law 480 and the Mutual Security Act, about 30 percent were subsidized dollar exports, and about 40 percent were unassisted dollar exports.

These proportions are not expected to change much in 1961. Lower cattle prices in the United States probably will reduce net imports of cattle and beef.

Because several of the leading export products are price supported, changes in exports often have more short-run influence on Government stocks than on farm prices. If current programs continue in 1961 and weather is normal, the total value of Government controlled stocks of farm products probably will remain at about $9 billion except for seasonal variation.

Farm population and income from off-farm sources: My comments to this point have dealt with commercial agriculture and with income received from farming. Nearly one-half of the farms enumerated in the 1959 Census of Agriculture sold less than $2,500 worth of farm products, and about one-third of all income received by people living on farms is from nonfarm sources.

Between 1954 and 1959, there was virtually no change in the number of farms with sales of $2,500 or more, but a 30-percent decline in those selling less.

The present high rate of unemployment is likely to bear particularly heavily upon the nonfarm income of farm people, and the slow rate of economic growth is an important obstacle to continued adjustment of the farm labor force to declining employment opportunities in farming.

The CHAIRMAN. Without objection, the Chair will recognize each member for 10 minutes for the question and answer period.

The first member to be recognized will be Senator Bush, to interrogate the witnesses.

Senator BUSH. Mr. Chairman, I am sorry I missed the earlier witnesses, particularly the first one and part of the second one.

I want to address a question or two to Mr. Reierson in connection with his comments.

You say:

> Moreover, with the economy apparently approaching the bottom of the current contraction the next few months may well bring signs of an upturn in business and in credit demand.

That is a very welcome statement. I wonder if you would care to expand on that.

Do you believe that during the spring we may see a reversal of the business trend or an upswing in it?

Mr. REIERSON. I would have very little faith in my ability to pick a particular month. I am a member of the school which believes, however, that we are approaching the bottom and I would guess at present that signs of an upturn will be in evidence my midyear.

Senator BUSH. Do you have any view to express to this committee about the desirability of the Federal Reserve purchasing long-term bonds?

Mr. REIERSON. I commented in my statement on this plan. I have a comment that takes maybe 2 or 3 minutes if I may take that much time.

Senator BUSH. I will be glad to have you use my time for that comment.

Mr. REIERSON. I think we are facing a difficult situation in trying to appraise just what the effect of this program will be. The program, of course, has two objectives:

On the one hand, it is intended to increase the flow of funds into the capital markets at lower yields.

On the other hand, it is supposed to avoid a further decline in short-term rates.

As the President points out, these objectives are in the very real sense contradictory.

I think one cause of uncertainty is that it is very difficult to tell what the effect of this program will be upon the decisions of investment managers. One assumption, to which I alluded in my statement, is that the sellers of long-term Government bonds will turn around and put the proceeds into the mortgage market or into the bond market. If they did, this would help achieve one objective of the program.

On the other hand, the additions to liquidity and bank reserves that would accompany the purchases by the Federal Reserve would contribute to lower short-term rates, which would be contrary to the second objective.

Therefore, I think under these circumstances the Federal Reserve would have to try to offset the downward pressure on short-term rates by selling Treasury bills or short-term obligations in the market.

Investors, of course, can shift out of Government and into alternate investment media right now. The shift would be encouraged under this plan, it seems to me, only if the yield differentials between Government and other media are widened.

This means that the yields on investment media would have to decline less than the yields on the long-term Governments.

Another problem is that yields on investment media can not get too much below the returns that investors anticipate will prevail 6 to 12 months in the future because if they do the investors are likely not to go into long-term obligations, but to go into short-term obligations until more favorable opportunities are available for long-term investment.

So the second alternative is that the investors, the sellers of long-term Governments, will reinvest the proceeds, not in long-term capital obligations, but in short-term issues.

This would, of course, impair the achievement of one major objective of the program.

It would also depress short-term rates which would be contrary to the second objective of the program. This would pose again the necessity on the part of the Federal Reserve to sell short-term obligations in an effort to hold up or prevent further decline in short-term rates.

On balance, however, I think it is very difficult to forecast exactly how the program will work out. I do think if some of the things to which I alluded in my opening statement are adhered to, the risks will be minimized.

I would hope that, in view of the uncertainty, the program would be cautious and moderate rather than aggressive and stupendous. Furthermore, the operations should be kept consistent with the objectives of general credit policy, that is, the purchase of long-term obligations should be made under conditions when reserves are to be provided to the banking system in any event, and these purchases should be regarded as substitutes for the purchase of shorter term obligations.

Certainly I think it is necessary to avoid the implication that the Federal Reserve effectively determine levels of long-term interest rates.

Another important consideration, and this one, I think, is favorable, is that action of this kind has a greater chance of succeeding if it is working in the direction in which market forces are working.

The market forces are likely to be operating in the direction of some declines in mortgage rates and in bond yields in the months ahead. In this situation a program such as this has an increased chance of having some of its desired effect.

However, this situation is not to be confused with the opposite; namely, an effort to use this program to prevent the market forces from having their effects upon interest rates, the consequences of which would be much more serious.

Senator Bush. I am glad that you brought out in the closing paragraphs of your statement the varying matters such as wages and prices and their effect on this balance of payment problem.

You state that our domestic policies will affect dollars, the purchase power of the dollar and dealing with these firmly would enhance opposition in the highly competitive world.

We hear some possibility exists of having a budget deficit this year, possibly one next year.

Would you care to comment on how a budget deficit next year might affect the balance-of-payments problem as we see it today?

Mr. Reierson. I think the economic impact of a budget deficit depends in very large measure on the state of the economy in general. If we experience a vigorous upturn in business activity, characterized by a resurgence of investment perhaps stimulated by tax reforms, and if at the same time we have large Treasury deficits and if by, say, the middle of next year we are at approximating full utilization of resources, the inflationary impact of budget deficits would obviously be much more serious than their impact in a period of economic slack.

Senator Bush. That would have an effect on the confidence factor?

Mr. Reierson. It could. Clearly the large treasury deficit that we ran a couple of years ago contributed to the uncertainty in the appraisal of the position of the dollar by the foreigners.

I think that the subsequent improvement in the budget situation, on the other hand, contributed to the improvement in the position of the dollar that was evident the first half of last year.

Senator Bush. I think I will yield, Mr. Chairman.

The Chairman. Senator Proxmire.

Senator Proxmire. Thank you, Mr. Chairman.

Mr. Chairman, I would like to ask Dr. Clague first, if I understood correctly.

Dr. Clague, did you say we would need a gross national product of $525 billion by the last quarter of this year if prices remain stable in order to have the 6.6 percent level of unemployment we have now?

Mr. Clague. Yes, that was the statement I made.

Senator Proxmire. And that if we had the continuation of the rising prices we have had over the past few years it would take $530 to $535 billion gross national product?

Mr. CLAGUE. Yes. I just want to emphasize that these figures are crude and rough and approximate, but they show that we shall have to get quite a substantial rise in the gross national product in order to bring unemployment down by the end of 1961.

Senator PROXMIRE. This would mean that in 1962, in February, we would have another situation of 6 million or more people out of work even if we should achieve that much higher level of gross national product and all the factors remain the same?

Mr. CLAGUE. Yes, unless the gross national product, once revival takes place, rises substantially as fast as it did in 1958–59 or back in 1955 and 1956. If we achieve a business revival in the second half of 1961, I would assume that it will continue with increasing sweep in the spring of 1962 and that, therefore, the unemployment would substantially decline at that time.

However, we would still have our normal seasonal swings, and there would be a seasonal decline from December 1961 to January or February 1962. On balance next winter's unemployment might not be 6 million or even 5,400,000. It could be substantially less than that.

Senator PROXMIRE. Now, Professor Brandow, on page 3 of your statement you refer to a dairy product. You point out by special law support prices for manufacturing milk and butterfat, were increased 5 percent last September. That law expires, March 31, so it seems to me this same generalization could be made about your paper.

Does not the income of dairy farmers depend to a very, very great extent on the actions by the Secretary of Agriculture and by the Congress?

Let me make it a little more clear.

If the law which expires March 31 should be continued or if the Secretary of Agriculture should support prices to the full extent he can under the present law, would not this make a very distinct difference in view of your assumption of increase in milk production.

Does not your prediction depend on the action of the Secretary of Agriculture rather than economic forces, generally?

Mr. BRANDOW. I think that is right, particularly with respect to manufacturing milk. This would be less true of milk sold for fluid consumption.

Senator PROXMIRE. In general is it not true of the farm economy. It is awfully hard to predict in terms of economic forces because so much depends on what a new Congress or new administration decides to do.

Mr. BRANDOW. This is correct. We are producing in excess of what commercial markets are taking.

The level of consumer income does not have a big impact on demand of farm products unless we get very marked changes in consumer income.

With cotton and the grain prices depending very largely on the level of Government support and with livestock products, especially hogs, reflecting the price support of grain, a great deal does depend on where these price supports are placed and on how effective Government action might be so that we don't continue to accumulate stocks and incur costs that the public will not bear.

Senator PROXMIRE. Thank you, sir.

Now, Dr. Smith, in your presentation you say that your survey now is in its 14th year, this is opinions of economists as to what is going to happen in the future.

It has regularly pointed out the direction that the economy will take in short run. I do not want to detain you any length at all, but I wondered if you could make available for the record in condensed form, it would be very useful to me, this kind of summary indicating when the economists have been right, and when wrong, and the extent they have been right and wrong.

Mr. SMITH. This is a qualitative judgment because almost invariably they are wrong with respect to the exact numbers.

This is to be expected because you are averaging several hundred numerical forecasts. If one group is forecasting a peak at one time and another group is forecasting a decline at the same time, the average of those numbers would indicate "no change."

So there is a great deal of judgment that has to be applied in interpreting what they mean.

In general, though, I would say they have tended to be a little too conservative in the magnitude of the changes, but they have been pretty good in pointing to the direction.

Senator PROXMIRE. That is exactly what I wanted. I would not expect them to be precise.

The CHAIRMAN. Without objection, the supplemental information from Mr. Smith will be inserted in the record at this point.

(The information referred to follows:)

The Dodge economist's survey has been conducted covering each year from 1947 on. The number of economists participating has ranged from 72 in the first year to 327 in the latest. The median forecast of the economists for gross national product has correctly indicated the direction of movement in GNP for each year except 1947, 1948, and 1950—an average of 79 percent correct for the whole period, and 100 percent from 1951 on. This should not be interpreted as meaning a high degree of precision either as to magnitude of changes or timing within the years covered. But in broad terms, as stated above, the survey "has regularly pointed the directions the economy would take in the short-run future."

Senator PROXMIRE. Now, Dr. Smith, you make a statement:

It is more difficult to forecast future trends in the contracts themselves.

It seems to me this is a field in which you particularly would be expert. It may be generalizing the whole economy may be difficult, but this is one area where you and your organization specialize.

If you gentlemen cannot give us any very precise estimate of what the contracts are going to be in the future except, of course, the assumption that the contracts in being will be continued, it would seem to me that it is hard for us as Members of Congress to depend on forecasts.

This is your field, this is your specialty.

Mr. SMITH. Yes, sir; I don't think any forecaster in the country in any field claims to be infallible. I will point out that we do make a precise, detailed forecast each year to the best of our ability.

This forecast is included in the table in the back of this statement, in dollar terms, in area terms, and in percent change.

I might say that with some luck we came within about three-quarters of 1 percent of the actual total in our forecast for 1960.

I say this is the exception rather than the rule. We do not claim infallibility, but I don't know any other forecaster who can.

Senator PROXMIRE. That is remarkably accurate.

Do you not think in the coming year, once again, as with Professor Brandow, the prediction depends very much on the action of Congress?

Mr. SMITH. Yes, sir; he said there are two major uncertainties for agriculture, the first is weather, and the second is Government programs.

This is almost equally true of construction because the weather has profound effect on it, but Government programs have even greater effect.

Senator PROXMIRE. I have one quick question for Dr. Reierson.

Did I understand you, Mr. Reierson, to say the Federal Reserve did not determine long-term interest rates effectively?

Mr. REIERSON. That is my judgment; yes, sir.

Senator PROXMIRE. Woud you say in the thirties and forties the action of the Federal Reserve, together with other agencies of the Government, affected the long-term interest rates pretty decisively, for better, or for worse?

I am not arguing whether it is a good policy.

Mr. REIERSON. I think in the thirties the main factor was the absence of credit requirement due to the depression.

During the war we had an entirely different situation with economic controls of many kinds, and the effort in the credit markets was concentrated on the short end of the credit markets.

As I recall, a three-eighths-percent Treasury bill rate was maintained during the period of the war financing, but no attempt was made to maintain a pattern of long-term rates.

Senator PROXMIRE. Was not the general effect, however, of the Federal Reserve and the Treasury Department to keep long-term rates below the level they otherwise would have been if only because of the influence of short-term rates on long-term rates?

Mr. REIERSON. This effort contributed, but there were many other factors operating during the war.

Senator PROXMIRE. I am saying that the Federal Reserve itself, and I wonder if you will contradict this, has a very great impact on interest rates during the period of the thirties, and the forties, and they were certainly one of the most important factors in maintaining a low level of interest rates during this period.

Would you contradict this?

Mr. REIERSON. I would differ as to the thirties. I think the depression was much more significant.

During the war the absence of capital requirement from the private sector also contributed very materially to the low level of long-term rates.

The CHAIRMAN. Congressman Curtis of Missouri.

Representative CURTIS. Thank you, Mr. Chairman.

I want to get a couple of details straight.

Mr. Paradiso, when you were talking about the State and local deficits, that would be exhibited primarily by bonds, would it not, municipal and State bonds?

Mr. PARADISO. That is true.

Representative CURTIS. Then, Mr. Clague, in trying to locate where our people in education and research and development are included in the employment figure, they would largely be in service and in State and local government; would they not?

Mr. CLAGUE. Not entirely, Mr. Curtis. Of course, in education, yes; they would be.

Representative CURTIS. They would be in service and in State and local governments?

Mr. CLAGUE. Yes. But there would be some research and development in corporations that might be in heavy industry, or in some of the other industries.

Representative CURTIS. That is the next refinement I was going to ask.

For instance, the people in Bell Laboratories would be included in whatever industry they were in even though their work might be in research and development?

Mr. CLAGUE. That is right. I think the ones that would appear in the service industry group would be those who were consultants or were research organizations as such. Then they would appear in the service industries.

Representative CURTIS. Now, this is a general question. Many people have made comments to the effect that the cutback in inventory is the basis of this recent recession.

First, if anyone might disagree with that, I wish that they would comment, but the question I have is, Does anyone feel that the relative price stability that we have been experiencing in the past 2 or 3 years, possibly longer, has had any magic effect on this cutback in inventory or the failure to build back inventory?

Start with Mr. Paradiso.

Mr. PARADISO. I don't see any evidence of the price stability being a factor in the inventory movement.

Essentially what happened in inventories is that in the first half of last year there was a large accumulation of inventories, particularly by manufacturing durable goods industries partly as a reflection of the rebuilding of stocks which were depleted during the steel strike of 1959.

But also, in reflection of anticipated higher sales during this year, which did not materialize.

So, many manufacturers were caught with high inventories in relation to sales and, as a result, beginning about the middle of last year, they began to cut these down and, as I indicated in my statement, primarily in the raw materials and goods in process stocks.

On the other hand, because sales did not rise, they were forced to accumulate some finished goods stocks.

So I don't think this was a phenomenon of price stability, but, rather, a phenomenon which was associated with the trend of final demand in the various sectors of the economy.

Representative CURTIS. But why would not some build back their stocks, and I understand they have not, to the level that we would call the normal levels of the previous decade, for example.

Mr. PARADISO. There has been some increase, but in very limited areas because the total net effect has been and is now, I believe, a continued liquidation.

There is also this phenomenon. Over the postwar period there has been a tendency for a reduction in inventory sales ratios.

Representative CURTIS. That is right.

Mr. PARADISO. I believe in the past 6 months or so, this trend has been accelerated.

In other words, manufacturers are making use of the fact that goods can now be delivered rather quickly. They have new inventory control systems and so forth.

Representative CURTIS. Computing machines and so forth?

Mr. PARADISO. Yes.

Representative CURTIS. That was the next question I was going to come to because if inventory is such a big factor in this recession, I think it is important to examine in some detail just what has been going on here.

I cannot help, and these are my own personal views, but feel that price stability has had a tremendous psychological impact. In one way it is an ill wind that blows nobody good, I guess.

If anybody is anticipating an inflationary movement, why, it would encourage a building back to some degree of inventory which might have some effect on coming out of this recession.

Mr. PARADISO. I think, Mr. Curtis, what happens is that when prices start to increase, then you tend to get inventory accumulation at a fairly rapid rate because obviously the attempt is to acquire goods before the prices get higher. This is also conditioned by the nature of the demand. In other words, you have to have a rising demand trend before you go to the point of accumulating stock.

Representative CURTIS. I believe the demand, of course, is very basic, but it seems, if my analysis were at all accurate, we might be experiencing something that is quite interesting plus the impact of the computer machine on inventory controls at this time coming at the same time when it looked like we were going to get continued price stability.

Would anyone else like to comment, because I do not want to shut you off on this? I do have other questions, but would anyone else like to comment on this? If not, I would like to go to Mr. Clague and ask this question:

I notice you are relating just the gross national product indicator to the factor of unemployment. I am wondering how good an indicator gross national product is to really estimate growth, technological growth, growth which is meaningful in a society.

Here is what I am getting at: In your figures one of the basic trends you have called to our attention is the shift from manufacturing to the services and the distributive fields.

It seems to me that gross national product, I will put it the other way, that manufacturing, particularly in the plant and heavy equipment, has a multiplier effect in gross national product while investment or money spent in education, research, and development, is almost a one-shot proposition.

The same, to a lesser degree, perhaps, would apply to services and the distributive fields.

If we could hold everything else still, I wonder if a shift from employment in manufacturing into service and distribution would not show a decline in gross national product. Yet we actually would be having a very dynamic economy because the net result would be better living for everyone, also greater potentials and capabilities of the overall economy.

Mr. CLAGUE. Yes, Mr. Curtis, that is quite conceivable that you could have a decline in manufacturing. We have, in fact, dropped about 900,000 workers since last January in manufacturing.

Representative CURTIS. In employment, but not in productivity.

Mr. CLAGUE. I am using employment as the test there. It is true you might have an expansion in summer hotels, winter hotels, in all kinds of attendance at the movies and things of that sort, which would be called services.

Representative CURTIS. Let us include education. I like that because that is where future growth is going to come from and research and development.

Mr. CLAGUE. That is right. And some of the youngsters who don't find summer jobs might go to summer school instead and get an education.

Representative CURTIS. And in education, too, our society is educating our people longer. There is a very marked trend of the length of time our people are spending in education.

Mr. CLAGUE. Correct; and this shift to the services is taking place. It shows in our consumer price index.

One of the reasons that our service prices, and the consumer price index, keep rising is that we have a greatly expanding demand for these services.

I am reminded of one—medical care. Because of all the insurance that people have for medical care, they ask for more medical care.

So there are pressures on hospitals, nurses, doctors, all kinds of services of that sort.

One of the problems of the unemployment situation is that the male heads of families, high-wage earners in steel, automobiles, longshoring, all the metal industries and so on, are not the kind of workers who move over to take these jobs in the service industries. They can't work in 10-cent stores, they don't become nurses, and they can't become educators.

As a result we have a hard core of unemployment of senior male workers now developing that shows up in our figures every month.

Representative CURTIS. These are the obsolete skills that come about through technological advancement to a degree.

Mr. CLAGUE. Don't call them obsolete. Those skills do exist somewhere else perhaps, but there is a big gap, there is a great immobility.

Representative CURTIS. Take Dr. Brandow's field of agriculture where technological advancement has been so rapid that one man can do what five used to do decades ago.

We have these skills. In many instances they are almost unskilled and semiskilled, but there is not the demand in the society for that kind of labor.

In fact, we see a continual contradiction, do we not, of lack of demand for unskilled and semiskilled labor. And at the same time in every one of the depressed areas we see demand for skills that apparently do not exist, that cannot be filled.

Mr. CLAGUE. That is right.

Representative CURTIS. Now, what I am getting to is this: I want to inject another factor. I have seen figures that indicate that about 30 percent of the products on the market today are new, that were not on the market 5 years ago.

Probably this is even greater in the field of services. We have plant obsolescence of about 30 percent which largely is the result of technological advancement.

We see this situation in the employment area where the employment rate during the recession continues high.

It seems to me all of this is the result of a very dynamic economy that is actually moving forward rapidly in creating these problems.

These are problems of dynamism and not what some people say are sluggishness and tiredness in the economy.

That is the comment if anyone would like to address themselves to it.

Would you comment on that?

Mr. CLAGUE. If we have an economy which is shifting away from capital goods, from new technology, from expanding capital investment, it is true that the labor force will move into the service industries in which the wages are lower, the incomes of people are lower, and there is a depressant effect on the actual gross national product figures.

Representative CURTIS. Not necessarily lower wages at all. For example, take technicians—these are higher skills that have been created and they command higher wages; and education, I don't believe this is so. I think the contrary. It is a movement into areas of higher skill and the net result is going to be increases which can be absorbed by the increased productivity that comes about through the use of these better skills.

Dr. Paradiso, do you want to comment on this?

Mr. PARADISO. I would like to comment on your general statement with regard to the relationship of a gross national product to employment.

There are three factors in this relationship. One is the employment. The other is the hours worked per week.

At this point I am wondering whether this lag which you have, Mr. Clague, in your relationship between employment and gross national product, might not disappear if you used man-hours instead of employment.

Mr. CLAGUE. Yes; one reason for the lag in employment is that hours recover first.

Mr. PARADISO. The other factor is productivity. I think you are perfectly right that the relationship between employment and income originating in any segment, such as services or parts of manufacturing, could be distributed because of the developments you just mentioned.

But I might indicate that if the total gross national product is related to man-hours introducing a productivity factor there is a very close correlation.

I want to emphasize this because I don't believe it is true that the relationship is disturbed over a period.

Man-hours and productivity do bear a very close tie-in to the movement of the gross national product or production.

Representative CURTIS. Even when that shifts from manufacturing to services?

Mr. PARADISO. That is right. Even when there is a very substantial shift as between services and manufacturing or when one considers the product mix.

Representative CURTIS. My time has run out. I would like to leave this one observation and hope that some scholar will undertake to make a study.

What happens in gross national product if a billion dollars goes to school construction as opposed to a billion dollars going to teachers' salaries?

I suspect that there is a real multiplier factor in school construction which does not exist in teachers' salaries, using gross national product as a test of what has happened in the society as a result of that.

The CHAIRMAN. Congressman Bolling, of Missouri.

Representative BOLLING. Thank you, Mr. Chairman.

Mr. Paradiso, can you estimate the effects on Federal expenditures on income and product account basis of the proposal made by President Kennedy in his economic message?

Mr. PARADISO. At the moment we cannot estimate the effects obviously in terms of dollars, because some of these proposals involved actions by the Congress.

Others have not been put into effect as yet. However, I might say this: Looking over all these proposals, there does not appear to be very large effect on the purchases of goods and services of the Federal Government.

In other words, most of these proposals are designed to help and bolster purchasing power through giving further payments to the unemployed; they include loans and grants of various kinds.

These do not affect purchases of goods and services in gross national product. They are reflected in what we call other Federal expenditures which include transfer payments.

So at the moment while we have no way of indicating in terms of the magnitude how much is involved here, obviously this cannot be done until Congress acts on a number of these proposals—nevertheless, it does appear that from the nature of the proposals the effect will be primarily on transfer payments, grants-in-aid, and things of that kind, rather than on purchases of goods and services.

Representative BOLLING. Thank you, Mr. Paradiso.

Mr. Clague, in your statement you suggest that an unemployment rate of 4.4 percent would result if full recovery were to come this year.

How much of an increase in gross national product do you think would be needed to bring full recovery this year?

Mr. CLAGUE. Well, I hesitate to play these figures that far because they are rude approximations, but generally speaking we estimate that a million men employed for a year would produce, say, seven or eight or nine billion dollars' worth of gross national product.

Now, on page 15, I estimated a difference of $2\frac{2}{10}$ million between the number now unemployed and the number if we recovered this year to the 1957 level. That would mean multiplying seven or eight by two and two-tenths. It would come around sixteen or seventeen billion dollars.

Representative BOLLING. This would be on top of the between 535 and 530 billion?

Mr. CLAGUE. Yes.

Representative BOLLING. The end result would be what?

Mr. CLAGUE. 545 maybe.

Representative BOLLING. 545 to 550?

Mr. CLAGUE. Yes.

Mr. PARADISO. You say to get full employment this year you would go up to $545 billion in 1960?

It sounds a little too high.

Mr. CLAGUE. Wait a minute. It maybe. My first calculation was for unemployment in the fall of 1961, at a seasonally adjusted annual rate.

Representative BOLLING. Your first calculation was 535 without price change. It went up to 535, having the same unemployment in the next December that we had in the last December?

Mr. CLAGUE. That is right, in the fourth quarter.

Representative BOLLING. I am trying to get at now if we had full recovery.

Mr. CLAGUE. Yes.

Mr. PARADISO. There are several ways of getting the answer for 1960.

Now, you might derive a full employment estimate of GNP for 1960, for example, by starting with the fourth quarter of 1955, which was a full employment period.

If you take the change in the labor force from that fourth quarter of 1955 to 1960, apply a 2 percent increase in productivity, which has been the average for the postwar period, you would come out with $535 billion in 1960 prices as being the equivalent to full employment.

That means we would have 4 percent of the labor force as unemployed under those conditions.

Five hundred and thirty-five billion dollars would, it seems to me, be roughly the magnitude involved for the full year 1960. For 1961, the estimate would be roughly $15 billion higher; again in 1960 prices.

Representative BOLLING. If you add six or seven that is involved if you add a price increase of one and a half you get up to 540 or something.

On that basis, it would be in the order of 540 or 545.

Mr. PARADISO. Whatever price you want to assume. If you assume a certain price increase this would be added to the 1961 estimate, that is correct, sir.

Representative BOLLING. Thank you. That is all.

The CHAIRMAN. Senator Javits.

Senator JAVITS. Gentlemen, first I would like to greet the New Yorkers who are here, I think it is Dr. Reierson and Dr. Smith, and thank you for your testimony which I think the world should know that this is quite a voluntary contribution to the well-being of our country, and we should express our appreciation to those who come out of private life for this high purpose.

I would like to ask my question particularly of you, Mr. Clague, if I may.

How does this slump which we are having now compare with previous ones, 1957, 1958, 1953, 1954, and 1948-49 in intensity?

Mr. CLAGUE. In a general way I would say that the business pattern we have been seeing is that the level of unemployment has been gradually rising both in prosperity periods and in recession periods.

I think that rise in unemployment is partly due to the technological shifts that Mr. Curtis was talking about, and the fact that we are having a rapid growth now in the labor force.

We had almost a forced draft economy in the 1950's. We had fairly substantial price rises in each prosperity period.

We had the Korean war with price and wage controls, but with a shortage of labor.

We had a rise in the military forces. In other words, a forced draft economy.

Now, we have reached more of a balance. Capacity has caught up with demand. It is a question whether prices can be raised even though there is a wage increase.

Under these circumstances this unemployment figure has been slowly but gradually rising. I think this is borne out by the present situation.

I would not regard this as a deep recession right now, in terms of other economic factors than employment and unemployment.

Senator JAVITS. Other than that it compares advantageously with the others, it is not as pronounced a recession, other than in unemployment?

Mr. CLAGUE. That is right.

Senator JAVITS. Now, could we ask you this fundamental question:

You have given as an estimate of gross national product required to meet the problems of new workers, productivity increases at some $20 billion more for 1961 than is the anticipated result seen by Dr. Paradiso.

In short he speaks of $515 billion. You speak of $535 billion.

Could you, or perhaps one of the other gentlemen, tell us what you think will most nearly bring us to that productivity increase?

For example, would you place the emphasis on a tax cut or would you place the emphasis upon greater automation, or upon an effort to reduce featherbedding? I would like to emphasize in this report that I think vice presidents who are unnecessary are as much featherbedding as workers who are unnecessary. I think this needs to be emphasized to all the American people. There are a lot of featherbedding vice presidents and I know them well. I am not referring to political Vice Presidents. They are very necessary; besides, there is only one.

But what I would like to ask you is: Where should we place our greatest emphasis? On automation, increase in productivity, reduction in featherbedding, on export expansion, and on other efforts to expand, let us say, the development of the less developed areas or in some other direction?

Mr. CLAGUE. Is that addressed to me?

Senator JAVITS. I will ask you first.

Mr. CLAGUE. I think, Senator Javits, I would like to say that as a Government official I would rather not comment on some of the policy questions involved in what you are suggesting there.

I don't know that anybody can answer them, really.

Let me just add one point. I indicated in my paper that I do think labor and management are going to face this issue of automation, of productivity, of job protection, of care in wage and price relationships, during the year 1961.

I don't want you to take my emphasis on a 1½ percent possible price increase in the consumer price index as gospel.

If we have a tough year it could be that we will get a further decline in the prices of durable goods. Automobile prices are the lowest in our index since 1957. So are household appliances.

It could be that we won't have any general price increases at all. If food prices would come down a little, we might actually get a decline in the index. But that will depend on what happens in agriculture.

I once thought that meat prices would be lower now than they actually are. It does look as though beef prices might come down. That would help our index a good deal. But we will have to wait and see what finally happens.

I think the central problem is that technology is developing in a good many industries. The displaced workers cannot be absorbed in new jobs in the industries where they are and they are not finding openings in other industries elsewhere.

Senator JAVITS. Mr. Reierson, would you care to address yourself to that subject? You are not in the Government in forecasting business economics, or are you?

Mr. REIERSON. This is a case in which I wish I were in Government service.

Let me say I have no clear-cut program in mind. I think that the situation is very complex and we have to do a lot of different things. Certainly I think we need some tax revision and I am not speaking of a temporary tax cut—I am speaking of a more fundamental tax revision. And I would not limit it necessarily to the stimulation of investment, although I think this should be a significant objective.

I think we need to try to increase the mobility of some of the factors of production in the economy, especially of labor, and to try to increase geographic and other mobility of labor. I would agree that stimulation of exports would be appropriate.

The agricultural program I certainly think needs a thorough overhauling from various points of view.

So we could go down the list. We might consider the desirability of price adjustments in order to stimulate demand and increase markets.

Senator JAVITS. I might say, Mr. Reierson, that you are a vice president, too. My comment did not apply to you.

Dr. Paradiso, I would like to ask you one question. I think I have another minute or two.

In your estimate of $515 billion of gross national product in 1961, I gather you did not make any assumptions about legislation of the kind we are discussing, for example, conceivably depressed area legislation containing provisions dealing with the issue of relocation.

Conceivably there could be legislation on adjustment assistance as to imports, again dealing with this question of retraining and relocation.

Did your assumptions, then, touch upon legislative recommendations including those made by both President Eisenhower and President Kennedy?

Mr. PARADISO. Let me make it quite clear that the $515 billion is not my estimate, nor my assumption. It is the assumption which was used by the previous administration in order to come up with a calculation of the probable receipts, Government receipts, for fiscal years 1961 and 1962.

In making that assumption, account was taken of the probable effects of the Federal programs which were in President Eisenhower's budget, in addition to making some judgment with respect to the way the economy will go this year.

Senator JAVITS. Thank you, Mr. Chairman. I think I have used up my time.

The CHAIRMAN. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Reierson, you perhaps deserve a rest, but I do not want to give you one. You are always willing to tackle tough problems when you appear before this committee.

This morning you tackled one of the toughest—how to reconcile the need for somewhat higher short-term rates to minimize money movements to foreign countries with the need for somewhat lower long-term rates to stimulate capital investment, housing, borrowing by State and local governments. In trying to work out a reconciliation between those two goals you do not lose sight of, as some have, a third worthy goal, the goal of lengthening or at least not shortening the national debt. You propose a solution which relies on the issuance by the Treasury of securities in the maturity range suited to commercial bank investment.

I guess you are talking about something like 2 to 5 years.

Mr. REIERSON. Yes, sir.

Representative REUSS. Let me say that I think this is a step in the right direction, and I admire you for tackling the problem. However, I am going to suggest that there may be a somewhat better way of doing it.

One difficulty I have with your proposal is that although it is better than just issuing 90-day bills, 2- to 5-year issues would not achieve much debt lengthening.

Secondly, putting these securities into the commercial banking system creates problems for the future. The more national debt that is held by commercial banks, other things being equal, the more difficult it may be for the Federal Reserve System at some future date to tighten credit.

Mr. REIERSON. Yes; this does pose a possible problem.

Representative REUSS. I do not mean to be hysterical. The banks do hold enormous amounts of the national debt. But if we increase commercial bank holdings, we should do so for good reasons; is that correct?

Mr. REIERSON. Yes.

Representative REUSS. As of yesterday, the Federal Reserve portfolio of some $27 billion was almost entirely in securities of less than 5 years maturity. I think only about 6 percent of the entire portfolio was in securities of longer than 5 years maturity. Why would it not be sound monetary and debt management policy, in the period to come, for the Treasury to put out substantial quantities of longer term obligations—5, 10, 15, 20 years—both to replace shorter term securities which come due and to finance any deficit which may unfortunately occur in the next year, and why, concurrently with that, couldn't the Federal Reserve shift its portfolio more into longer terms? This need not involve any pegging which I agree is undesirable.

Would not this come closest to accomplishing the combined national objectives of slightly higher short-term interest rates, slightly lower long-term interest rates, a lengthened average maturity for the national debt, and a slightly lower carrying charge on the national debt, all without any real disturbance of the present institutional arrangements, the public confidence, and so on?

Would you comment on this as a possible alternative to your own constructive suggestions?

Mr. REIERSON. May I ask for a clarification? I am not sure I understand exactly what you have in mind. You suggest that the Treasury make a public offering of long-term issues?

Representative REUSS. Yes; in moderate amounts.

Mr. REIERSON. The difficulty is that then you run counter to the objective of getting lower long-term rates.

Representative REUSS. It should not, if concurrently, Mr. Reierson; the Federal Reserve System would embark upon a coordinated policy of shifting its portfolio in the general direction of longer terms.

Mr. REIERSON. You mean the Treasury would sell longer term securities to the public and the Federal Reserve would turn around and buy an equivalent amount from the public?

Representative REUSS. Not necessarily an equivalent amount. If you want both to issue long-term securities and to seek somewhat lower long-term interest rates, I should think the Fed would, over a period, augment its portfolio of longs by a somewhat larger amount than the net addition of long-term securities.

I do not like to assign figures to this because it is very tricky. However, let us just suppose that the Treasury in the next 12 months would issue $2 billion worth of 5-, 10-, 15-, and 20-year securities and the Fed would augment its pitiful portfolio of long terms to $5 or $6 billion.

As I say, one needs to be careful about using figures, but I want to try to make it a little easier for you to answer.

Mr. REIERSON. This is an intriguing idea, Mr. Reuss, and we always get involved in interesting discussions when I come down.

I would agree certainly that my proposal does not solve the debt-lengthening problem.

In my statement I said my proposal would make the debt-management problem less serious than exclusive reliance upon short-term issues. I think that my suggestion has one pertinent advantage over yours, and that is that it puts the commercial banks in a better position to meet the loan demand that will be forthcoming in the years ahead.

What has been happening, as one of my charts show, is that we have had a very sharp rise in the loan-deposit ratios of commercial banks. This is real in the sense that it has had a deterrent effect upon the lending desires and capabilities of the banks.

These ratios have improved somewhat recently and I think that some further improvement will be forthcoming in the months ahead.

But what I am suggesting is that down the longer road, if the commercial banking system is going to fulfill its necessary function and preserve the sort of balanced relationships and asset composition which bankers think are necessary, then my program would have the advantage of putting the banks in a better position.

Representative REUSS. May I interrupt to state that I agree with what you said? But would it not perhaps be best if we did some of both?

Why not put out some 2- to 5-year securities for the commercial banks and why not also put out to real savers some longer term securities with the Fed taking steps by concurrent portfolio switches to see that we do not undo objective No. 1, that of lowering or at least not raising long-term rates?

Can you not do both?

Mr. REIERSON. It is much easier to plan these things than to achieve them, I believe.

In this environment I am rather doubtful that the Treasury would find it desirable to enter the long-term markets.

I think you get into many imponderables as to the impact of such a program upon the flow of investment funds. It is possible that the purchasers of the long-term governments offered under your suggestion would buy them in lieu of mortgages.

The sellers of the long-term obligations to the Federal Reserve would not necessarily put the proceeds into mortgages or long-term bonds. They might put the proceeds into short-term obligations with the result that the major objective of the program would not be achieved.

Representative REUSS. To minimize the shift from long term to short term the short-term rate must not rise so high and the long-term rate sink so low that normal investment preferences would be disturbed.

But I do not think that is particularly related to this discussion here.

Mr. REIERSON. I think it is the essence of it, because if you sell long-term Treasury obligations to investors, presumably the immediate impact of that on your program would be to reduce the amount of funds they would put into the capital markets including real estate mortgages.

Representative REUSS. Not if concurrently the Federal Reserve is shifting its portfolio into longs.

Mr. REIERSON. But the point is that it will be very difficult to guarantee that the sellers of the long-term Governments to the Federal Reserve will put the money back into the capital markets. This is again an area of uncertainty. You can't be sure that they will put it back.

Representative REUSS. You would be pretty sure if the interest rate stays at about the same level.

Why can't you be sure?

Mr. REIERSON. Because I think the expectations of investment managers as to the future course of interest rates are real. I think they have to be reckoned with.

I suggest that one of the things that would have to be considered, is what investment managers might do, if the long-term yields got down below the level at which these investors think they might be able to invest long-term funds 6 or 12 months ahead. I think this situation would provide a very real and potent incentive to them to put the money, not into the long-term market now at relatively low rates and yields, but into short-term obligations, pending more favorable investment opportunities in the future.

Representative REUSS. The remedy is to keep an appropriate spread in the rates.

Thank you very much.

Mr. REIERSON. I should like to continue this discussion.

Representative REUSS. We will later on.

Thank you, Mr. Chairman.

The CHAIRMAN. Congressman Widnall.

Representative WIDNALL. Mr. Chairman, I wish to express my apologies to the members of the panel for not being here at the beginning of the session, so I did not hear all their testimony.

I have not heard all the questions. I just would like to address myself to the testimony of Mr. Clague.

Do you believe that the retraining of workers is more important than the relocation of industry?

Mr. CLAGUE. I don't know that one can answer that definitely. I think I would have to say a qualified "Yes" to that.

Workers are very hard to move. Let me start out with that. Workers are very hard to move, especially mature workers, heads of families who own their homes and have lived in their communities for a long time.

It seems somewhat easier to bring the industry to the workers than to get the workers to move.

This is not true with younger workers. We have found when we surveyed certain distressed areas of the country, and analyzed the structure of their labor force, that there is a somewhat smaller proportion of younger workers, probably because they have left home and gone somewhere else.

Young teenagers, workers 20 to 24 years old, unmarried, boys and girls both will move.

But the settled families do not.

I think it is somewhat easier to move industry than it is to move workers.

Representative WIDNALL. But there is inherent in the relocation of industry the danger of just transplanting employment problems from one place to another. I notice that a man in charge of redevelopment in the Commonwealth of Pennsylvania prided himself on the fact that a great many industries had come into Pennsylvania, but they have taken away industry from New Jersey, New York, and the New England States to the extent of 19 major plants creating unemployment in those States.

We are faced with that unemployment when Pennsylvania benefits by the new employment.

So certainly any pirating is one of the major things that must be considered in the depressed areas legislation.

Mr. Clague. Of course, you can't assume that there is a firm ceiling on employment or on production. One has to hope that the shift that takes place results in more employment being created or larger production occurring, that the shifting around results in a net gain overall.

It may not always happen. It may be that a shift in one direction is completely offset by a decline somewhere else.

Somehow, if the movement is good, if you end up with a solvent business concern which can produce in this new area successfully without lowering standards, there should be an additive factor which makes for the net growth of the Nation's product instead of just a shift—a plus in one place and a minus in another.

Representative Widnall. I wonder if the members of the panel are familiar with the research program project that Syracuse University did for the State of New York, submitted this year to the Governor and the State legislature.

At that time in their study of upstate New York, and also the New England areas, that have been chronically depressed they reported that while relocation of industries was a major program to be considered, it had not proven the answer in any of these areas even where there had been concerted redevelopment effort.

The new industries have never provided employment for the full number of unemployed. The research report stated that retraining and the mobility of the workers and also the care of the workers while they were being retrained came ahead of the relocation of industry.

Mr. Clague. I would like to endorse that. The retraining which enables the worker to get out of being an unskilled unemployed, and to become qualified to hold jobs which are open, certainly is a prime public consideration.

One advantage of that is that retraining may result in the worker's being reemployed in the area in which he now lives.

Of course, it might not. It might involve his moving.

But retraining could result in reducing what I call occupational immobility.

We would get a higher skill, lower wage costs, and improvement in the economic situation by that retraining.

Representative Widnall. I only wonder whether it is uneconomic for the Government to say that, because there is some unemployment out on the Pacific coast, destroyers should be built on Pacific coast at $7 million more than in an east coast shipyard.

This is why Government is doing what the electrical companies did. They are working to spread the employment.

In connection with our defense effort in particular, I know we are all subject to pressure to bring defense business into our particular areas, but in the critical financial position that we find the country in today. I question whether it is the economical approach and right thing to do if there are better skills in some areas than in other areas and production can be faster, and the end result can be better so far as the economy is concerned, than by attempting to spread the work throughout the congressional districts.

Do you have any opinions along that line?

Mr. Clague. I would just indicate this: I understand that in all those cases there is a margin or limit beyond which they don't go.

Obviously the system is based upon the theory that it is better to get some work to the unemployed workers where they are, and that there will be secondary advantages of that which won't show up in the cost right away.

I would rather refer that to some of my colleagues who may know more about this particular policy.

Representative WIDNALL. I am trying to run down a statement right now that has been made in connection with repairs of airplane engines. It is alleged, in spreading the work, contracts were let to an area where people were not trained in that particular process and today we are getting about 120 hours of service with a repaired engine whereas if they had been repaired in the original plant of the manufacture the result would be a thousand hours. This is a tremendously high cost to the taxpayers.

Mr. PARADISO. I am not an expert on this, but it seems to me it does make some sense to argue that if you have coal miners in a particular area who cannot do much of anything else but mine coal, that if you provide some other type of work in that area, you are not going to have the labor force there unless it comes in from elsewhere.

Consequently, it seems to me the problem is to find the kind of projects which are suitable to the type of labor force and skills available in the area to make any program effective or to retrain these people.

Representative WIDNALL. Thank you.

The CHAIRMAN. The Chair is glad to recognize and to welcome on behalf of all members of our committee, our new member; the distinguished Congresswoman from Michigan, Mrs. Griffith.

Representative GRIFFITH. Thank you, Mr. Chairman.

I would like to address my first question to Mr. Clague, if I may.

If the gross national product was $503 billion in 1960 and, in order to have full employment, you estimate that it would mave to be $535 billion in 1961, I ask in what previous years outside of war years did the economy ever show such a big increase?

Mr. CLAGUE. Remember that I was comparing the fourth quarters of 1960 and 1961. I was using quarterly figures. I believe there have been several such occasions—perhaps Mr. Paradiso can tell us—I will say that I have the impression that it grew that fast in 1955.

Mr. PARADISO. 1955 was such a period. We came out of the 1954 recession rather rapidly. In the second half of that year we were at, what we might call, full employment rate.

The 1948–49 recession was followed by an upsurge in the gross national product, but then, you see, we had the Korean situation which was a factor in that case.

Now, we did not get back to a full employment situation following the 1957–58 recession.

Mr. CLAGUE. I might add one more point.

In 1958–59 we came out very fast, but in 1960 we stumbled. There was at least a year, from the first quarter of 1958 to the summer of 1959, when we moved up very fast indeed, but the achievement is clouded by the inventory accumulations in anticipation of the steel strike.

So this last experience is a little irregular. In any case it does not show up in the calendar year figures.

Representative GRIFFITH. Autos are one of the softest spots in the economy. Would you care to estimate what we could do to remove the auto excise tax?

Mr. CLAGUE. I am afraid I haven't studied that.

Representative GRIFFITH. Mr. Paradiso, would you think that would have an effect on it?

Mr. CLAGUE. In some sense automobiles are suffering from the fact that we have had a tremendous accumulation of cars. They were in short supply during the greater part of the 1950's. Many families that wanted them had to take secondhand cars or do without.

Now we have acquired a very substantial volume of cars and the competition that the auto industry has to face is that of replacing old cars by new cars. Of course, we still have the growth factor, but the replacement market may now be the larger.

In that sense, I would have to say that almost anything which would reduce the price of cars a little would probably sell some more of them to the public. How much effect it would have in terms of another 100,000 autos marketed, I would not know.

Representative GRIFFITH. In his speech on February 2 to the Congress, in his economic message, the President pointed out that the economy of 1960 should have hit a figure of about $540 billion which would have been an 8-percent increase, I believe.

Actually, then, under full employment is not the 1961 figure of $540 billion a little too low?

Mr. CLAGUE. We are talking about price increases included in this, are we?

Representative GRIFFITH. Yes.

Mr. CLAGUE. To get down to three and a quarter million or so, which would be a 4-percent rate of unemployment, I think 540 might be a little low, assuming a 1½-percent price increase.

We always compare real product and employment when we make these analyses, assuming no changes in prices.

Possibly the figure ought to be a little higher than that in order to really get down to an average unemployment level of three and a quarter million.

Representative GRIFFITH. Thank you very much.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. Mr. Chairman, I will be very brief.

I have listened with interest to the exchange of questions. I, being a farmer, want to get back on this farm problem a little bit, Professor Brandow.

One sentence on the first page of your statement which I want to ask you about; it seems to be contradictory.

> The one year of the past seven when farm income was significantly above the average for the period was 1958, and in that year when unemployed hit its postwar peak.

Mr. BRANDOW. That is right. You want me to comment on this?

Senator SPARKMAN. Yes, to a layman it seems to me contradictory.

Mr. BRANDOW. In the postwar period the income of American consumers has been sufficiently high that moderate changes in income have had very little effect on food demand.

When we have had recessions such as in 1954 and 1958, unemployment compensation and things like that apparently have served to stabilize food expenditures remarkably well.

So on the demand side the modest recessions we had in the postwar period have not had much effect on the demand for food.

Now, the thing that was unusual about 1958 was largely on the supply side of the market. Two or three things happened.

One was that in the winter of 1957–58, Florida and California both had freezes that reduced supplies of fruits and vegetables, and this boosted prices of these products.

These products are not price supported and in general the demand is inelastic so that growers receive more income from a short supply than from a large supply.

Also, in 1958 the cattle and hog cycles to which I referred were turning corners, and the kind of corner they were turning was one where market supplies were light and prices high.

In other words, supplies of both cattle and hogs were somewhat short in 1958.

The demand being inelastic, the result was that the producers received more income from the short supply than they would have from a large one.

In grains, we had a different situation. We had extremely good weather for wheat and good weather for corn. In a free market this would have depressed prices and growers' incomes. But these commodities were price supported, which meant that farmers marketed large volumes of these crops at stable prices and received more income.

So the combination of these factors meant that in 1958 income was the highest of the past 7 or 8 years.

Senator SPARKMAN. In other words, there were simply different factors influencing agricultural economy on the one hand, and industrial economy on the other?

Mr. BRANDOW. That is right.

Senator SPARKMAN. Now, with reference to the surpluses under your title commodity prospects, you say:

> Feed grain supplies have risen each year since 1952.

As a matter of fact, it is in that particular field, is it not, in which we have our greatest difficulty here, the farm surpluses?

Mr. BRANDOW. Feed grains and wheat.

Senator SPARKMAN. And wheat, yes. I intended to include wheat?

Mr. BRANDOW. That is right.

Senator SPARKMAN. I notice your statement with reference to the cotton. You say stocks of cotton are still rather large. Is it not true that the carryover of cotton for this year promises to be the smallest we have had since 1952?

Mr. BRANDOW. I believe that is right. When I said rather large, I merely meant to imply that if we had no surpluses to worry about—and we have had surpluses in recent years—we might choose to have around 5 million.

We are not much above that now. Carryover is smaller, by half, than we had 4 or 5 years ago.

Senator SPARKMAN. Yes, of course, just a few years ago we had an embargo on cotton; as a matter of fact, do you not think we need normally a carryover of 7 or 8 million bales.

Mr. BRANDOW. I think that is slightly large, but it is not so much on the high side that I would be disposed to argue about it.

Senator SPARKMAN. There is a statement on the last page of your paper that interests me:

> Between 1954 and 1959 there was virtually no change in the number of farms with sales of $2,500 or more, but a 30-percent decline in those selling less.

Then you say:

> The present high rate of unemployment is likely to bear particularly heavy on the nonfarm income of farm people.

This thought occurred to me. Do you not believe that the disappearance, just decline of 30 percent of small farms, has within itself contributed to the unemployment problem?

Mr. BRANDOW. As I understand it, the unemployment percentages cited here today have been unemployment expressed as a percent of the total labor force which includes agriculture.

Possibly it would be more significant to express this percentage by taking the agricultural labor force out of the total labor force and look at it that way.

I think there has been a substantial outflow of laborers from small disadvantaged farms into industry, and they have not had skills that permitted them to get jobs and hold them unless industrial employment was pretty high.

To a degree I think we have shifted underemployment in agriculture to unemployment in industry.

Senator SPARKMAN. I have just one other question. There has been some discussion in the press from time to time about a stimulus to higher production, by getting some kind of better or greater allowances in the form of rapid depreciation for new plant and equipment.

Of course, we provided that depreciation in 1954, as I recall.

Is it not true that we had a more rapid expansion of productive capacity as a result of that than the economy was able to use and was not that really a contributing factor in the recession of 1957 and 1958?

I will throw that out as a general question.

Mr. SMITH. Senator, could I make a comment on that?

Senator SPARKMAN. Yes.

Mr. SMITH. I think there is something to be said for this because the obvious ways to help the economy recover in a recession are to increase these various types of investment programs.

This includes not only plant and equipment, but housing as well.

A good question can be raised at this time as to whether such stimulation will simply produce more excessive capacity in plant and equipment, causing further problems later on.

If we don't really need this capacity over the short run, there is a good question as to what effect it may have.

I would tend to raise the same question, perhaps, about housing, that with vacancy rates the way they are and tending to creep up a little bit, excessive stimulation of housing will run into some difficulties too along the same lines.

Senator SPARKMAN. Let me say I agree with you. I believe we do have still a very high demand. Someone on this panel stated we would need 1,300,000.

I think that is a fair estimate. I agree with you we have to watch, Congressman Patman, Congressman Widnall, and I are all on the housing subcommittee. We have to keep those things in mind.

There is one thing that is a little irritant to me. I supported the tax program in 1954 and I thought it was very good. Yet I have always felt that an inequity was generated by the use of the term "new."

Now a concern may want to buy new equipment and I think that is fine, fine for them to do it, but they are going to dispose of that used equipment and the firm that is going to buy that used equipment is usually a small plant that gets no consideration for rapid depreciation of the equipment.

It means just as much to that small businessman in carrying on a productive enterprise as does the new equipment to the big business.

Now, you do not have a satisfactory answer as to why we should restrict it to new equipment, and not make it likewise applicable to used equipment. Does anyone have a comment on that?

I may say I have introduced legislation from time to time to try to get that corrected, and I am going to keep on trying.

I just want to know if I am right, or if I am wrong I would like to be told so.

Mr. SMITH. I would think in providing a market for the used equipment, helping to provide a market for second-hand equipment this would in turn help to improve the market for the new equipment.

Senator SPARKMAN. Yes, certainly it would. At the same time it would enable that small business that cannot afford the new equipment to expand his productive capacity which I think is just as important as enabling the bigger business to expand theirs because certainly small business in this country is a large part of our economy.

That is all.

The CHAIRMAN. Thank you, gentlemen, very much. You were very kind to come down here to give us the benefit of your views.

You have given us some excellent suggestions.

We will shortly consider not only what you have stated in our oral statements, but also everything that you have filed with the committee.

It will be printed. It will be distributed to all the Members of the House and all the Members of the Senate and all agencies of Government and go to all the principal libraries of the Nation.

I know it will be very helpful to our people who are charged with the duty of passing the laws necessary to keep our economy going at the proper speed and at full employment if possible.

Thank you gentlemen, very much.

Now, may I announce that this afternoon at 2 o'clock, we will have Mr. Walter Reuther, chairman of the Economic Policy Committee of the AFL-CIO, and at 3 o'clock Mr. Emerson Schmidt, Director of Economic Research of the Chamber of Commerce of the United States, and at 3:30 o'clock Mr. George C. Hagedorn, Director of Research Department, National Association of Manufacturers.

At 1:30 we have an executive session of the committee here in this room.

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The Chair desires to urge the members to be present, if at all possible at 1:30.

Thank you.

(Thereupon, at 12:30 p.m., the committee was recessed, to reconvene at 2 p.m., same day.)

AFTER RECESS

(The joint committee reconvened at 2 p.m., Representative Wright Patman, chairman of the committee, presiding.)

The CHAIRMAN. The committee will please come to order.

This afternoon we will hear from representatives of labor and management on the economic report, the economic situation and outlook. The representative of labor will be Mr. Walter Reuther, chairman of the Economic Policy Committee of the AFL–CIO, and he will have the first half of the afternoon's discussion.

Mr. Emerson Schmidt of the Chamber of Commerce of the United States, and Mr. George G. Hagedorn, of the National Association of Manufacturers, will divide the second half of the afternoon.

As I stated in my opening remarks this morning, we are fortunate in that not only do we have the economic report of the outgoing administration, but also several economic messages of President Kennedy on which to base our discussions during this period of changeover.

Mr. Reuther, we are indeed pleased to have your views, and we will ask you now to proceed in your own way. I hope it will be possible, however, to limit your opening statement to such time as to allow questioning by members.

If you summarize your statement, your full statement will appear in the record, of course. You may add anything you consider germane in connection with your remarks, or concerning questions asked you by members of the committee. You may proceed.

STATEMENT OF WALTER P. REUTHER, CHAIRMAN, ECONOMIC POLICY COMMITTEE, AFL–CIO

LABOR AND MANAGEMENT COMMENTS ON THE ECONOMIC REPORT AND THE ECONOMIC SITUATION AND OUTLOOK

Mr. REUTHER. Thank you, Mr. Chairman

I appreciate very much the opportunity of appearing here. I should like to express to your committee, and through you to the Members of Congress, our deep concern about the extremely serious economic situation that we find ourselves in and to urge you as Members of both Houses of Congress to take affirmative and adequate action in the implementation of those programs so essential in getting America back to work.

We have prepared a written statement which I should like to submit for the record, Mr. Chairman, and then to elaborate on this orally, if I might.

The CHAIRMAN. It will be inserted in the record at this point.

(Mr. Reuther's prepared statement follows:)

STATEMENT ON THE PRESIDENT'S ECONOMIC REPORT, PRESENTED ON BEHALF OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATION: BY WALTER P. REUTHER, VICE PRESIDENT, AFL–CIO; CHAIRMAN OF THE AFL–CIO ECONOMIC POLICY COMMITTEE, AND PRESIDENT, UAW

The enormous problems that face our nation at home and abroad have been clearly put before the American people by President Kennedy.

The source of America's material power—our national economy—has been weakening ever since the end of the Korean war in mid-1953. For almost 8 years, much of our productive potential has been suppressed by a lack of balance between the economy's improving ability to produce and lagging public and private demand—a lack that has been aggravated by the Government's tight-money and restrictive budget policies.

Nearly 8 years of increasing joblessness and part-time work, a rising number of economically distressed communities and increasing amounts of idle productive capacity are stark testimony to the inadequacy of national economic policies which hampered us from utilizing so much of our heritage of skilled manpower and know-how, technological advance and productive equipment.

The rate of economic growth has slowed down to an average yearly pace of 2.4 percent in 1953–60—only about seven-tenths of 1 percent more than the yearly increase of the population. As a result of this shocking record of near-stagnation, there has been only the tiniest margin of additional national output for needed improvements in national defense, public services, social welfare and living conditions. All of this has occurred at a time when the Soviet economy has been growing about 6 to 7 percent a year and, in vast regions of the world, uncommitted nations have been seeking assistance for their own economic development.

The current recession and mounting unemployment of recent months are the latest examples of the deterioration of our national strength. They have been superimposed on an economy that never fully recovered from the two previous recessions of the past 8 years.

The joblessness and waste of the 1954 decline were never wiped out because the pickup was unbalanced and not sustainable. The 1958 recession brought a sharp decline in economic activities and a rise of joblessness to a weakened economy. The brief pickup from the spring of 1958 to the spring of 1960 lacked both strength and balance. Unemployment, during the upturn from the 1958 decline, was about as great as it had been in the recession year, 1954. The present recession started last spring, therefore, from a base that was undermined by frequently recurring recessions, followed by brief and incomplete recoveries.

These facts of our deteriorating economic situation cannot be denied or hidden. The cover of smug complacency has at long last been ripped off by the new administration. It is time that we looked directly and clearly at these troublesome truths.

To face the realities of our difficulties is a great and welcome advance over the failures of national leadership of recent years. But it must not end in a hypnotic trance or partisan bickering.

There are times for bold action. The present recession must be ended as rapidly as possible. Of equal importance is the urgent need to start meeting more adequately our social and individual needs, and to establish the foundation for sustained full employment and economic progress.

We of the AFL–CIO fully recognize the enormity of the task that lies before us. We called attention to the shortcomings of national economic policy as they developed and were compounded, year after year since 1953. We know that our present difficulties cannot be wished away or made to disappear by token actions.

Positive plans and policies are needed. The recession of 1960–61 must not be permitted to run its natural course. If it does, joblessness at the end of 1961 will be greater than it was last October–December and 1962 will witness persistent unemployment, considerably worse than in 1959 and early 1960. Furthermore, the postwar record indicates a business cycle of approximately 3 to 4 years' duration. On this basis, another recession could begin in 1963 or 1964, on top of incomplete recoveries from 3 successive recessions. The dangers and hardships to American families from such an occurrence are obvious. But even worse is the possibility of a loss of confidence in our economy—both at home and abroad—which continued slack and another sharp decline could bring in its wake.

The main job at present is to get America back to work. A powerful attack on the recession is required. Federal expenditures for public services and social welfare should be stepped up to take up the slack, while, at the same time, beginning to meet national needs more adequately. The unemployed and their families should be assisted.

President Kennedy's antirecession program, as spelled out in his economic message to Congress, and subject to the modifications proposed below, should be adopted and implemented quickly.

In addition, the President should be granted discretionary authority to reduce Federal taxes on individuals temporarily, in order to stimulate economic activities. Such reductions should become effective through a Presidential order, but Congress could, if it saw fit, reserve the right to annul or modify such an order. It is the judgment of the AFL–CIO that such temporary tax cut should be instituted when the unemployment rate, seasonally adjusted, exceeds 7 percent of the labor force. Such a quick lift to consumer incomes and demand may be necessary in the next few months, if economic activities are to be turned upward rapidly.

A decisive antirecession effort, however, is not enough. Full employment cannot reasonably be expected in a year that starts with recession and an unemployment rate of 6.6 percent of the labor force. A pick-up, in its early stages, results in increased working hours and sharply rising productivity, rather than in a substantial reduction of unemployment. With a labor force that is continuing to expand by over 1 million a year, high levels of unemployment will persist for many months after an upturn starts.

An antirecession program should be complemented by a long-range effort for sustained economic growth and full employment—to carry the economy forward, not only in the months immediately ahead, but in the coming years.

A rapid upturn from the present recession should be backed up by a sustained expansion of demand, production and employment. The economy's developing imbalances and structural difficulties of recent years must be eliminated and offset by a vigilant and continuing government effort.

The Federal Government's role in this effort is crucial. Under the Employment Act of 1946, the Government is committed to promote "maximum employment, production and purchasing power." The goal of national economic policy, therefore, should be maximum economic growth and maximum use of available manpower and productive equipment.

The goal of low levels of unemployment should mean that joblessness at any point in time is temporary and essentially due to seasonal fluctuations, shifts from one job to another and new entrants to the labor force—which, in our economy, would be an unemployment rate of not more than 2½ to 3 percent of the labor force. Anything above that level should be considered excessive, and due to inadequate demand or structural defects in the economy which can be corrected by proper policies.

To make possible the attainment and maintenance of these goals of adequate economic growth and full employment, the President's Council of Economic Advisers should present and publish each year its expert estimates of how much private consumption and investment and already planned public investment and other government expenditures may be anticipated for the year, and what additional government action is necessary to maintain full employment in the light of labor force growth and rising productivity. If such estimates were presented for the national economy as a whole and its major segments, they could become guidelines for private and public economic decisions.

President Kennedy's establishment of the President's Advisory Committee on Labor-Management Policy, can provide another vehicle for assisting private decisionmaking, on the basis of factual information, intelligent discussion and cooperation in a complex industrial and urban society.

The presentation of economic targets and the focusing of public attention on the basic economic issues of a complicated economy will, in itself, contribute to sounder decisions on employment, technological change, public and private investment, wages, prices, and profits.

Simultaneous efforts on many fronts to get the economy back on the road to full employment and sustained economic growth, with a reasonably stable price level, must not be thwarted by panic over the Nation's recent gold-flow problem and the underlying unfavorable international balance of payments. The solution to this problem is a growing domestic economy that will stimulate investment in the United States and provide the basis for continued confidence. A healthy economy cannot be achieved by blocking economic and social progress and permitting stagnation to persist. Negative policies that would limit economic growth in the name of a "sound dollar" could extend the present problem into a genuine crisis for the Nation. The gold-flow question should be solved—not by panicky actions, but by restoring confidence in the growth of the American economy, by flexible monetary policies and by joint efforts of our Government with the governments of the industrial nations of the free world.

The new administration has shown its ability to face unpleasant facts and to propose concrete and practical means for achieving progress. It is up to Congress now to make possible the implementation of programs to get America back to work, on the road to sustained economic expansion and full employment.

President Kennedy has given all Americans a sense of national urgency and national purpose. What we need now, above all, is a willingness to act, positively and resolutely, with faith in the capacity of freemen to solve their problems and to win over tyranny.

Extent of the problem

The present recession—the third since mid-1953—focuses attention on the near stagnation of the economy.

Between 1947, after the end of the war and reconversion to peacetime production, and 1953, the real volume of total national output rose by an average yearly rate of 4.8 percent. Since the population increased 1.8 percent a year, the growth of per capita real national production was at an average annual pace of nearly 3 percent. This 3-percent increase in national output per man, woman, and child in the population provided America with an ample margin of additional goods and services to improve living conditions, while defense expenditures were raised substantially.

Since 1953, however, frequently recurring recessions and incomplete recoveries have cut the pace of the economy's growth in half. Between 1953 and 1960, the real volume of total national production increased by an average annual rate of only 2.4 percent. The population continued to increase by about 1.8 percent a year. As a result, the average annual rise of per capita real national output was seven-tenths of 1 percent—an insignificant margin of additional production for improved public services and living conditions, more adequate national defense and a needed stepup of financial and technical assistance for the economically less-developed nations of the world.

TABLE 1.—*Slowdown of economic growth*

	Gross national product (1960 dollars)	Per capita gross national product (1960 dollars)
1960	[1] $503.2	$2,797
1953	[1] $425.5	$2,665
Average annual increase (percent)	2.4	0.7
1953	[1] $425.5	$2,665
1947	[1] $321.1	$2,228
Average annual increase (percent)	4.8	3.0

[1] In billions.

Source: Economic Report of the President, January 1961.

An indication of the cost of this record of near stagnation can be seen in the following facts:

From July 1957, before the 1958 recession started, to May 1960, the peak before the present recession, industrial production rose only some 8 percent—an average of a little over 2½ percent a year; in that same period, manufacturing employment dropped 400,000 and the total number of nonfarm wage and salary jobs increased only 600,000.

TABLE 2.—*Stagnation of production and fall in employment July 1957–December 1960*

	Industrial production (1947–49=100)	Nonfarm wage and salary jobs	Manufacturing employment
		Millions	*Millions*
July 1957 [1]	154	52.5	16.9
May 1960 [2]	167	53.1	16.5
December 1960	156	52.2	15.8

[1] Before start of 1957–58 recession.
[2] Before start of 1960–61 recession.

NOTE.—All figures are adjusted for seasonal changes.
Source: Federal Reserve Board and Department of Labor.

By last December, after 7 months of recession, the small gain in industrial production of the previous 3 years was almost wiped out and nonfarm employment was less than it had been before the 1958 recession started. Industrial production last December was only 1.3 percent greater than in July 1957; there were 1.1 million fewer manufacturing jobs; and there were 300,000 fewer nonfarm wage and salary jobs.

Almost 8 years of this process have cost the Nation hundreds of billions of dollars of accumulated lost production, rising unemployment, an increasing number of economically distressed communities and suppression of the pace of advancing productivity. For the 1 year, 1960, President Kennedy has estimated the loss at $30 to $40 billion of production. This means that we lost $6 to $8 billion of Federal revenue, almost 2 million jobs, and millions of additional man-hours of work that were lost forever due to part-time work because full-time jobs were not available.

The waste of the Nation's productive resources can be seen most clearly in the official figures on employment and unemployment shown in table 3.

TABLE 3.—*Total labor force, employment and unemployment*

	1953	1957	1960
	Millions	*Millions*	*Millions*
Total civilian labor force	63.8	67.9	70.3
Total employed	61.9	65.0	66.4
Agriculture	6.6	6.2	5.7
Nonagriculture	55.4	58.8	60.7
Total unemployed:			
Number	1.9	2.9	3.9
Seasonally adjusted rate (percent)	2.9	4.3	5.6
Persons at work: [1]			
Full-time, all industries	49.2	50.4	[2] 50.6
Part-time, all industries	10.2	11.6	[2] 12.8
Full-time, nonagriculture	44.4	46.2	[2] 46.8
Part-time, nonagriculture	8.6	9.7	[2] 11.1
Part-time for economic reasons, all industries [3]	(4)	2.5	2.9

[1] Excludes employed persons not at work because of vacation, illness, etc. Part-time is defined as employed 1 to 34 hours per week, full-time as 35 hours per week or more. Hawaii and Alaska included in 1960 figures.
[2] Adjusted to account for effects of Good Friday in employment survey week of April 1960, Lincoln's birthday in survey week of February 1960, exceptionally bad weather and illness in the early months of 1960 (adjustment by AFL–CIO).
[3] Persons on reduced workweeks for economic reasons and on part-time because full-time work was not available.
[4] Not available.

Source: U.S. Department of Labor.

In the 7 years, from 1953 to 1960—

The labor force increased by 6½ million people but employment increased only 4½ million. As a result, the number of jobless soared by 2 million—from 1.9 million to 3.9 million. The number of unemployed, as a percent of the labor force, increased from 2.9 percent to 5.6 percent.

But the record is even worse than these figures indicate. In those 7 years, when the labor force increased 6½ million, most of the rise in employment was in part-time work. Full-time employment increased only 1.4 million.

Despite the increase in the labor force, declines or lack of growth in employment were characteristic of most major sectors of the economy, as is shown in table 4.

TABLE 4.—*Nonfarm wage and salary jobs*

[In thousands]

	1953	1957	1960
All wage and salary jobs [1]	49,681	52,162	52,895
Mining	852	809	664
Contract construction	2,622	2,808	2,770
Manufacturing:	17,238	16,782	16,338
Production and maintenance jobs	13,833	12,911	12,265
Nonproduction jobs	3,405	3,871	4,073
Transportation	2,899	2,741	2,558
Class I railroads	1,207	985	781
Telephone and telegraph	747	810	742
Gas and electric utilities	552	577	579
Retail and wholesale trade	10,527	11,302	11,645
Finance, insurance, and real estate	2,038	2,348	2,485
Services	5,538	6,336	6,637
Government	6,645	7,626	8,458
Federal	2,305	2,217	2,237
State and local	4,340	5,409	6,221

[1] Excludes farm employment and nonfarm self-employed persons and unpaid family workers.

Source: U.S. Bureau of the Census and U.S. Department of Labor.

Factory production and maintenance jobs dropped 1½ million in the 7 years from 1953 to 1960.

Farm employment declined 900,000.

Railroad jobs fell over 400,000.

Mining employment dropped almost 200,000.

Federal Government employment declined nearly 70,000.

There was merely relative stability of employment in telephone and telegraph, gas and electric utilities.

While 3 million jobs disappeared in those sectors, there was an insufficient increase of employment in other parts of the economy, consisting frequently of part-time work at low wages.

Jobs in retail and wholesale trade rose 1.1 million and there was a similar 1.1-million rise of employment in the services, much of it in part-time work and at a fraction of the earnings in manufacturing, mining and the railroads where employment dropped sharply.

There was a rise of 670,000 nonproduction jobs in manufacturing—clerical, sales, executives, professional, and technical jobs—which meant very few alternative job opportunities for laid-off factory workers.

In finance, insurance, and real estate, employment increased 450,000—again mostly clerical and of little assistance to displaced factory workers, farmers, railroad workers, and miners.

There was an increase of 150,000 jobs in contract construction.

The sharpest increase was in State and local government employment, which rose almost 1.9 million—jobs for which few displaced workers were qualified by education, skill, and training.

There were scarcely more man-hours worked in the total private economy in 1960 than in 1953 or 1957—not because of any significant decline of standard working hours, but because the rise in employment in private industry was small while there was a great rise in part-time work and short workweek schedules.

Not only has unemployment continued to rise from one postrecession period to another in the past 8 years, but long-term unemployment of 15 weeks or more has also risen as jobs have been more difficult to obtain. In 1951–53, 12.7 percent of the 2 million jobless were unemployed for 15 or more weeks. By 1955–57, unemployment was up to 2.9 million, and 20.7 percent of that number were among the long-term unemployed. In 1959–60, 25.8 percent of the 3.9 million jobless were without work for 15 weeks or more. Both the size of the unemployment problem and the duration of joblessness has been increasing.

TABLE 5.—*Long-term unemployment is rising*

	Total number of jobless	Unemployed 15 weeks or more	Long-term unemployed, as percent of total number of jobless
	Thousands	*Thousands*	
1951 to 1953	1,967	249	12.7
1954 [1]	3,578	812	22.7
1955 to 1957	2,887	599	20.7
1958 [1]	4,681	1,452	31.0
1959 to 1960	3,872	998	25.8

[1] Recession years.

Source: Department of Labor.

This record of wasted potential is now being compounded by the recessionary decline of production and employment. The economy is continuing to move further and further away from full employment and maximum use of plant and equipment.

The economy's potential to grow, however, is accelerating. In the decade of the 1950's the total labor force increased by a yearly average of 820,000 or 1.1 percent. During the 1960's, according to estimates of the Department of Labor, the labor force is expected to increase by an average of 1.4 million a year or 1.7 percent. In addition, it is reasonable to expect output per man-hour of work in the total private economy to continue to advance at an accelerating rate as it has tended to do over the past 50 years. The average annual postwar rate, despite repeated recessions and ill-advised policies during most of the period, was 3.3 percent. The far-reaching technological changes that pour out of our research laboratories hold out the promise of future acceleration at faster than the historical pace, if the volume of demand and production is sufficient to warrant maximum, efficient use of manpower skills, plant and equipment.

The challenge that confronts us is not only the task of ending the present slump and eliminating the waste of joblessness and short-time work schedules that developed during the 8 years of near stagnation. There is the continuing challenge of providing jobs for the 13,500,000 increase in the labor force expected in the 1960's while automation spreads and productivity rises.

The economic outlook in 1961

As a result of incomplete recoveries from the 1954 and 1958 recessions, unemployment was already at a high level when the present recession started last spring. By the October–December quarter of 1960, 6½ percent of the labor force was jobless. When the unemployment loss of part-time work is added, the full-time equivalent of total and partial unemployment was about 7½ percent of the labor force.

Although some conservative business observers of economic developments attempt to hide the seriousness of the present unemployment problem by claiming that most of the increase in joblessness is among teenagers and women—as if this would not be serious in itself—the facts indicate that nearly three-fifths of all jobless people last December were adult men, 20 years of age or over. Of the 963,000 rise in unemployment between December 1959, and December 1960, the increase in jobless adult men was 667,000 or 69.3 percent of the rise in joblessness. The recent increase in unemployment has hit adult men hardest—most of them are heads of households.

TABLE 6.—*Unemployment, month of December 1953–60*

Month of December	Unemployed total	Unemployed adult men [1]	Adult men as percent of total
	Thousands	*Thousands*	
1953	2,676	1,529	57.1
1954	3,039	1,831	60.3
1955	2,657	1,433	53.9
1956	2,723	1,543	56.7
1957	3,374	2,062	61.1
1958	4,108	2,497	60.8
1959	3,577	1,970	55.1
1960	4,540	2,637	58.1

[1] Age 20 and over.

December 1959-60:

Increase in total unemployed	963,000
Increase in adult men unemployed	667,000
Increase in adult male unemployment as percent of total increase	69.3

Source: U.S. Department of Labor.

Accompanying this rise of idle manpower has been an increase of idle plants and machines. In December, about 25 percent of industry's productive capacity was idle. At the recent operating rates of the U.S. steel industry, we have been losing each week through idle capacity as much steel as the entire Russian steel industry produced in the average week of 1960.

TABLE 7.—*Operating rate as percent of industrial capacity, month of December 1954–60*

[Percent of manufacturing industries]

End of year		End of year—Continued	
1954	84	1958	80
1955	92	1959	85
1956	86	1960 [1]	75
1957	78		

[1] AFL–CIO estimate.

Source: 13th annual McGraw-Hill Survey, April 1960.

Sales, production, and employment have continued to decline since the start of the new year and joblessness has continued to rise.

Present trends indicate the probability of a continuing decline in the months immediately ahead.

The prophets of complacency would have us believe that the economy's built-in stabilizers—such as the unemployment insurance system and the progressive Federal income-tax structure—in addition to a modest stepup in the placement of Government contracts, will cushion the decline and provide the foundation for a pickup in the spring or summer.

These forecasts of a pickup within 3 to 6 months from now, without decisive antirecessionary measures by Government, indicate a willingness to be satisfied with very little progress.

Only a weak pickup, if any, can be expected in the spring or summer on the basis of present trends, if strong antirecession actions are not taken by Government. Present trends indicate that the number of unemployed will be 7 percent or more of the labor force at the end of 1961, unless comprehensive Government measures to increase purchasing power, production, and employment are quickly taken.

Business investments in new plants and machines is heading down moderately in the first half of 1961. Unless there is a rapid upturn of demand and production to bring about substantially increased utilization of existing plants and machines, business investment in capital equipment may continue to decline in the second half of the year.

Business inventories, which were built up sharply in the early months of 1960, will probably continue to be cut back in the coming months. It is not likely that there will be any significant rebuilding of business inventories in the second half of 1961, unless there is a substantial rise in demand.

Consumer spending cannot be expected to increase vigorously in the months ahead. The increase of consumer buying power has slowed down considerably in the past several years, and the foundation for a sustained, substantial rise of consumer spending has been undermined. In addition, consumers are now concentrating on repayment of debts which rose sharply between late 1958 and mid-1960.

Furthermore, the spread of unemployment and short workweeks has been cutting into family incomes. Even employed workers have seen the buying power of their earnings cut. Last December, as shown in table 8, the buying power of the average weekly spendable earnings of a factory worker with three dependents was 4 percent less than in December 1959 and somewhat below December 1955.

TABLE 8.—*Factory worker weekly earnings, month of December 1953–60*

Month of December	Net spendable earnings [1]		Month of December	Net spendable earnings [1]	
	Current dollars	1960 dollars		Current dollars	1960 dollars
1953	67.11	73.91	1957	75.26	78.31
1954	68.63	75.92	1958	79.60	81.39
1955	73.00	80.49	1959	82.50	83.17
1956	76.54	82.04	1960	80.35	79.71

[1] Worker with 3 dependents.

Source: U.S. Department of Labor.

As a result, consumer spending may falter in the early months of 1961 and rise at a slow pace, at best, during the remainder of the year, unless production and employment increase substantially.

An easing of mortgage rates on Government-insured mortgages will mean some improvement in homebuilding. But the low rate of family formation and the present distribution of income mean that a substantial upturn of private homebuilding may not occur in the next few years without a comprehensive Government housing and urban-redevelopment program.

On the basis of present contract placements and existing plans, Federal Government expenditures and spending by State and local governments are expected to rise only moderately during 1961.

These trends of recession in the early months of 1961, followed by a slight pickup in the spring or summer, would be a continuation of the stagnation we have experienced during the last few years. Only strong Government action can turn the present decline around with enough strength to place the economy on the road to full employment. At present, there are no signs of sufficient strength in the economy to provide a rapid and substantial upturn to maximum utilization of the economy's ability to produce in the absence of such Government action.

In the American economy—with rising productivity and resultant displacement of labor by improved technology, plus a labor force that is expanding by more than 1 million people a year—the real value of total national production must increase by approximately 5 percent or more per year, merely to keep unemployment from rising.

However, present indications are that the real value of total national production may rise no more than 3 to 4 percent, from a yearly rate of $503 billion at the end of 1960 to a rate of $518–$523 billion in the final quarter of 1961, on the basis of current trends. Unemployment under such conditions, would be 7 percent or more of the labor force—higher than it was at the end of 1960, unless depressed economic conditions depress productivity as they have in the past. This type of recovery would be a continuation of the economic stagnation and rising unemployment of the past 8 years.

If unemployment is to be significantly reduced, and full employment and production are to be attained, the economy must expand at a substantial rate.

It would take a growth rate of approximately 9 to 10 percent between the end of 1960 and the end of 1961 to reduce unemployment to a level that approaches minimum joblessness and full employment and a 5-percent growth rate thereafter to maintain full employment.

At first glance the size of the recovery problem is staggering. But based upon past experience it is certainly not beyond reason to hope and to plan to return to full employment during 1962. In the 2 years following the 1949 recession, our gross national product increased, in real terms, by 17.3 percent.

It may be said that this increase in GNP was accomplished as a result of the impetus provided by the fighting in Korea. But this argument answers itself. If we are able to mobilize our economy for the negative and destructive ends of war, why should be doubt our ability to mobilize it equally well for the positive and creative purpose of peace? During 1950 and 1951, Government supplied the stimulus by substantially increasing its demand for military purposes. Today, if we set about vigorously to meet our unmet public needs in such fields as education, health, housing, and resource conservation and development, we will thereby create added demand that will provide a powerful stimulus to greatly increased activity in the private sector of the economy.

The difference between recession followed by a slight pickup and significant economic progress in 1961–62 must be supplied by Federal Government policies. Positive Government actions are needed to end the recession as quickly as possible and put the economy on the road to sustained expansion and full employment.

The basic causes of the economic imbalance which has imposed three recessions on the American people and cut the rate of economic growth in half since 1953 must be eliminated.

Immediate measures to reverse the downward trend are needed. These steps should be backed up by long-range measures to assure stable economic growth and full utilization of human and physical resources. In addition, economic and social adjustments should be planned to ease the economy's developing structural problems which affect groups of workers, businesses, consumers, and communities.

Measures to reverse the decline

The present recession demands special attention and immediate action. Although solutions to long-run problems must be developed in order to strengthen the economy, antirecession measures should be adopted, without delay, to reduce hardship and get America back to work, on the road to full employment and maximum economic growth.

We therefore applaud the speed and vigor with which President Kennedy is moving to lighten the burdens borne by the victims of the recession and to bring the recession itself to an end. We support the 12-point program for economic recovery he presented last week. We hope that Congress will move without delay to enact the new legislation required to effectuate that program in full, together with certain additions to it that we suggest below.

We see in several of the 12 points the same spirit of compassion evident in the first act of the new administration—the Executive order increasing the variety and quantity of surplus food distributed to needy families. Similar concern to reduce human hardship is reflected in those of the 12 points which call for temporary extension of unemployment compensation, coverage of children of the needy unemployed under the aid-to-dependent-children program, pilot food stamp programs and improvement of the school-lunch program, improvement of old-age, survivors, and disability insurance, and higher minimum wages and extension of coverage under the Fair Labor Standards Act.

These measures will not only help the unemployed and low-income families; they will also add to purchasing power and thus contribute to recovery. By so doing they will reinforce the effectiveness of the remaining 12 points which deal with monetary policy and debt management, housing and community development, expansion of the Employment Service, redevelopment aid to distressed areas, early payment of veterans' life insurance dividends, acceleration of Government procurement and construction, and Government procurement preference for labor surplus areas.

All these measures are sound and desirable from both an economic and a humane standpoint. They are a refreshing change from complacency in the face of the economic waste and personal and family tragedy associated with recessions. They symbolize the determination of the new administration to take seriously the responsibilities placed upon it and the mandate given it by the Employment Act of 1946. We hope that Congress, similarly, will do its part in implementing that act.

In presenting his program, President Kennedy himself took account of the possibility that it might prove to be inadequate and promised, in that event, to submit further proposals to the Congress within 75 days. We believe that it would be wise to consider certain additions to the President's program designed both to increase the likelihood that that program will achieve its purpose and to supplement it quickly should that become necessary; specifically:

1. *Temporary tax reduction.*—We urge the enactment now of legislation giving the President discretionary authority, subjcet to disapproval by Congress, to reduce personal income taxes temporarily when necessary to stimulate the economy. Such action would have quick effect in raising consumer demand, thereby stimulating economic activity.

We propose that if and when the seasonally adjusted unemployment rate exceeds 7 percent, the President be authorized to suspend the first $10 of withholding taxes each week for a period of 10 weeks with such reduction limited to $100 per year per taxpayer. An equivalent reduction should be given at the end of the year, or on estimated quarterly returns, to taxpayers not covered by withholding.

If such legislation is enacted immediately, it will cost nothing in revenues if unemployment does not rise above 7 percent or if the President, based upon his reading of the economic indicators, refrains from using the discretion granted him. If, on the other hand, the other measures proposed do not prove adequate to the task of starting the economy on the road to recovery, enactment of this proposal now would eliminate delay in putting it into effect should it become necessary to do so. It is our judgment that such a temporary cut will be imperative if unemployment should rise about 7 percent in the next few months.

This proposal, we believe, is superior to the suggestion of the Samuelson Task Force Report which would provide a 3 or 4 percentage point reduction in the tax rate applicable to every income class over a period of about 8 months. For most taxpayers, the Samuelson proposal would mean an increase in take-home pay of less than $3 a week—an amount hardly likely to have sufficient and sufficiently quick impact on consumer demand.

2. *Unemployment compensation.*—We fully agree with President Kennedy that our unemployment compensation system needs permanent improvement as well as temporary shoring up to reduce hardships flowing from the recession and to foster recovery. We would prefer to see the total job done immediately through the enactment now of permanent Federal standards covering benefit, duration, and eligibility, broadened coverage and strengthened financing provisions, with benefits and duration supplemented temporarily by the Federal Government up to the level of the permanent standards until the States have had time to conform to them.

We believe that permanent reform of the unemployment compensation system must include—

(*a*) A minimum Federal benefit standard requiring the States to set benefits equal to at least 50 percent of the individual worker's regular weekly wage subject to a maximum no less than two-thirds of the State's average weekly wage.

(*b*) A minimum Federal duration standard requiring the States to provide benefits for at least 39 weeks to all eligible workers who remain unemployed that long.

(*c*) Federal standards to eliminate the restrictive eligibility and harsh disqualification provisions that have been written into the State laws.

(*d*) Extension of coverage to all wage and salary employees regardless of the number working for their employers.

(*e*) Improved financing provisions designed to eliminate dangerous interstate competition in reducing contribution rates and to reinsure the State funds against unusually heavy benefit withdrawals.

The administration is forthrightly on record on the need for permanent reform of unemployment compensation as well as for temporary action to meet the immediate crisis. We fully agree with President Kennedy's view, expressed in 1958 and reiterated in his message of last week, that:

"* * * it would be a tragic mistake to embark on a Federal supplementation program geared to the present emergency without also strengthening the underlying system. A mere stopgap approach ignores the role our permanent unemployment insurance system was intended to play, and establishes instead a precedent for falling back on temporary remedies whenever the system is really needed. The standards of the system have proven inadequate to deal with the recession problem.

This time we must establish a permanent unemployment compensation system which can do the job it was intended to do."

In the light of this statement, we interpret the administration's action in introducing separate legislation for temporary supplementation as an indication of a judgment that consideration by Congress of the details of permanent reform might delay action to meet the immediate crisis. We accept the President's assurances that he will move vigorously to achieve fundamental revision and strengthening of the system in this session of Congress. We therefore support legislation for temporary supplementation, not as a substitute for, but as an immediate prelude, to action on permanent reform.

Such temporary legislation, in our judgment, should include provision for Federal supplementation of benefit amounts as well as duration. The supplementation of benefits should be sufficient to assure all workers of at least 50 percent of their regular weekly earnings up to a maximum of at least two-thirds of the average weekly wage in their respective States. These added benefits would increase significantly the contribution of unemployment compensation to economic recovery. In addition, Federal supplementation should provide for benefit payments to persons with substantial earnings records who are not presently covered by the unemployment compensation laws.

We hope that Congress will not only move swiftly to put into effect the stopgap of Federal supplementation, but will also act promptly on urgently needed permanent reform of the unemployment compensation system.

3. *Old-age, survivors, and disability insurance.*—The President's proposals for improvements in the old-age, survivors, and disability insurance program represent long overdue steps in the right direction and should be enacted without delay. Their enactment, however, must not be permitted to interfere with early action to meet the imperative need for a program to provide medical care for the aged under the social security system.

In addition to the humanitarian reasons for the President's proposals for social security improvements, he noted that they will aid in stimulating recovery by adding to purchasing power. The proposed increase in the minimum benefit for retired workers from $33 to $43 is certainly necessary and desirable. The President noted his own wish that the increase could be greater. However, the increase in minimum benefits will be less than fully effective in terms of increasing purchasing power because many present recipients of retirement benefits at or near the present $33 minimum are receiving supplemental old age assistance benefits which are likely to be reduced if their old age insurance benefits are increased. We urge, therefore, that Congress give consideration to providing specifically that the $10 increase in minimum retirement benefits may not be used to reduce supplemental old age assistance payments.

We believe, further, that the present $74 per month average retirement benefit is grossly inadequate and that not only the minimum but the general level of benefits should be raised both to provide more adequately for the needs of retired workers and to make a larger contribution to the purchasing power needed for recovery from the recession. Increases in benefits can be financed by raising the ceiling on taxable wages above the present $4,800.

4. *Minimum wage.*—We urge that the minimum wage under the Fair Labor Standards Act be raised immediately—rather than in two stages—to $1.25 per hour, at least for all industries presently covered by the act. We urge further that coverage be extended to all workers engaged in activities affecting interstate commerce. If it is considered inadvisable to provide a $1.25 minimum immediately for all newly covered workers, provision should be made for periodic increases in the applicable minimum—which certainly should be no less than $1 at the start—to bring it to $1.25 as quickly as practicable. In addition, industry committees similar to those provided under the original act should be created to bring such workers, industry by industry, under the $1.25 minimum as rapidly as it can be done without substantially curtailing employment opportunities.

5. *Housing.*—The reduction in the maximum interest rate on FHA-insured mortgages announced by the President last week is a step in the right direction. But, in our judgment, larger steps are essential if housing is to make its proper contribution to recovery. With 25 million Americans living in substandard homes, as President Kennedy pointed out, unfilled needs for decent housing and good neighborhoods are so tremendous that they provide a great potential for stimulus to the economy.

We believe, first, that a reduction in the maximum interest rate by a mere one-quarter of 1 percent—from 5¾ to 5½— is not nearly enough. We propose that the rate be set no higher than 4½ percent in order to provide adequate stimulus to housing demand.

Whatever the maximum interest rate that is set for this purpose, however, it can easily be nullified if lenders continue to discount mortgages, i.e., to pay the sellers less than the face value of the mortgage, thus effectively increasing actual interest rates above the legal maximum.

The Federal National Mortgage Association plays a crucial role in determining actual as distinguished from fictitious interest rates on mortgages. However, according to the Wall Street Journal for February 6, FNMA will continue to buy mortgages at a discount, although the discounts will be fixed at such levels as to yield slightly lower actual interest rates than at present.

We urge action to assure that maximum interest rates fixed for FHA–insured mortgages become the actual rates. This can be done by providing FNMA with authority to buy mortgages on a larger scale than at present and by directing it to pay no less than face value for the mortgages it buys and authorizing it to pay more than face value if that should prove necessary to hold interest rates in the mortgage market to the 4½ percent ceiling we propose.

6. *State and local public works.*—We urge Federal action to encourage and facilitate increased public works expenditures by States, counties, and municipalities. Many State and local public works projects have been engineered, planned, and programed, but are being delayed by cost problems that could be overcome with the aid of Federal grants providing for a small part of the total cost. It is estimated that as much as $2 billion of additional State and local public works expenditures could be made in 1961 as a result of the stimulating effects of $300 million in incentive grants by the Federal Government.

* * * * * * *

The foregoing suggestions, in our opinion, are all compatible with the President's 12-point program and would supplement and strengthen it. We hope Congress will give them serious consideration and will proceed without delay to enact them together with those parts of the President's program which require legislation.

LONG-RANGE EFFORT FOR BALANCED ECONOMIC GROWTH

A long-range program for sustained economic progress is needed to correct maladjustments and imbalances that have developed in recent years. Prompt measures to counter the recession should be backed up by a comprehensive effort to maintain the economy on a course of full employment and balanced economic growth.

We must plan for at least a 5-percent economic growth rate

Although it may have startled some who have come to accept complacent platitudes as a substitute for perceptive diagnosis of our economic situation, President Kennedy's economic message to Congress in some respects tended more to understatement than the reverse. Nowhere was this more noticeable than in his estimate of an existing potentiality for growth in the country's economic output at a rate of 3.5 percent per year.

The President was very clear in his contention that a 3.5-percent annual growth rate was insufficient. He said: "This is not high enough. Our potential growth rate can and should be increased. To do so, we propose to expand the Nation's investments in physical and human resources, and in science and technology."

We have no quarrel whatever with the proposition that our potential growth rate should be increased, nor with most of the means proposed to increase it. In a world in which physical deprivation is still far too common an occurrence—and not only outside the boundaries of our own country—every advance in our ability to meet human need is to be welcomed, and every improvement in physical or human resources is a contribution to progress. But the acceptance of a 3.5-percent figure as representing our present potential growth rate far understates our existing capabilities. We have already proved our ability to do much better than that.

In the period 1947–53, in spite of the recession of 1948–49, our real national production increased at an average rate of 4.8 percent per year.

In the whole period 1947–58, according to a study made a little more than a year ago by the Bureau of Labor Statistics, output per manhour worked in the total private economy increased at an average rate of 3.5 percent per year. Taken in conjunction with the 1.2 percent annual growth of the labor force in the period, this should have produced an increase in total annual output equal to over 4.7 percent per year, less a small allowance for the reduction in working hours that took place in some industries during the period. Its failure to do so was primarily a consequence of a lack of sufficient demand, resulting in rising unemployment, part-time employment, and short workweeks since 1953.

The administration's calculations of a 3.5-percent present potential growth rate are based in part on the 2 percent long-term average rate of productivity advance over the past half-century or more. In other words, it is assumed that with all our modern technology and skills, productivity today cannot be expected to advance at any faster rate than it did in the first decades of this century. Such an assumption is contrary to all our practical experience, as well as to the statistical record of the actual rate of advance. In the 1959 Annual Report of the National Bureau of Economic Research, Solomon Fabricant remarked on the manner in which the pace of productivity advance was speeding up. 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."

Independent analyses of the statistical data going back over 50 years, made by the Bureau of Labor Statistics and by UAW technicians, both confirm the fact of acceleration in the rate of productivity advance. The results of both studies indicate that while the average rate of advance over the past half century has been a little over 2 percent per year, there has been a strong tendency for the rate of productivity advance to accelerate. The 2-percent rate represents an averaging out of figures which 50 years ago stood at less than 1 percent per year, and today stand in the neighborhood of 4 percent per year.

The true potentialities for growth today have been blurred in recent years because the economic policies in effect have led to recurrent recessions with only partial utilization of our productive capacity in the periods between recessions. This in turn has meant production at less than maximum efficiency, so that our true potential for productivity advance has not been realized.

But, despite the grossly misguided national economic policies of recent years, our actual performance was significantly better than the 2 percent annual increase in productivity which the President's message takes as the basis for measuring our present growth "potential."

For the whole Eisenhower period, 1953–60, the average annual rate of productivity advance, despite severely repressive economic policies, was 2.6 percent. This was far less than could and should have been achieved, but still very significantly more than the rate of productivity increase upon which the President's message estimated our present growth potential at 3.5 percent annually.

As stated above, a BLS study for the period 1947–58 showed an average rate of productivity advance of 3.5 percent per year. Even if the figures are extended to 1960 and the beginnings of the current recession, it shows an average annual rate of productivity advance for the period of 3.3 percent.

We fully concur in President Kennedy's espousal of the objective of increasing our economy's potentiality for growth. But we believe it would be an error to base either short-range or long-range estimates and policies on such a serious understatement of what our current growth potential is. That will lead only to the setting of goals which fall short of what we could achieve, with a consequent continuation of high unemployment.

Adoption of programs which will get America back to work and build a solid structure of full employment will be accompanied by substantial increases in productivity per manhour as we begin to make fuller and more efficient use of our productive capacity. On the basis of experience following previous recessions, it is highly probable that in the near future, as we commence the march toward economic recovery, there will be a temporary spurt of productivity advance at a rate substantially above 4 percent per year, with a leveling off as we approach fuller utilization of capacity and a final trend toward a rate which will accelerate by a small increment each year at a level commencing in the neighborhood of 4 percent.

Taken in conjunction with an expected increase in the labor force of 1.7 percent annually during the current decade, this means that our volume of national production can increase by 5 percent or more each year and still provide some leeway for taking part of the productivity advance in the form of increased leisure. On the other hand, if we should fail to achieve a growth rate of 5 percent, we would face rising unemployment and underutilization of resources.

We get what we plan for

The importance of making a sound analysis of our potential for economic growth is that in order to realize that potential we must plan to make use of it. Unless our private and public spending and investment add up to a total of effective demand equal to our production potential, that potential will not be realized. One of the major causes of weakness in the economic policies of the previous administration was its lack of belief in our true potentialities for national growth. In consequence, every sign of an increase in effective demand tended to be viewed as a threat of inflation which needed to be repressed, rather than a stimulation toward economic growth which needed to be encouraged.

We are confident that the new administration will not make that mistake. But if our existing potentiality for growth is understated, we will tend to adopt national economic policies geared to less than full production, and by doing so we will tend to achieve less than full production. That tragedy must not happen.

The Rockefeller Brothers Fund report, "A Challenge to America," pointed out that "a growth rate of 5 percent is possible if we realize fully our impressive opportunities for economic expansion."

The platform adopted by the Democratic National Convention last July declared:

"We Democrats believe that our economy can and must grow at an average rate of 5 percent annually, almost twice as fast as our average annual rate since 1953. We pledge ourselves to policies that will achieve this goal without inflation."

Let us direct our national economic policies with that goal still before us.

Prosperity and price stability

Those who see the bear of inflation behind every bush are attacking current proposals to bring us out of the recession as being inflationary—the same shopworn tag that they have tried to fasten to every proposal to meet our economic needs and support a sagging economy during the past 8 years.

The measures proposed are primarily designed to increase the aggregate demand in our economy for goods and services. It is because effective demand for goods and services has lagged so far behind our capacity to produce them that measures to increase demand are essential. Our country has 5½ million men and women unemployed—with no demand for their services at all. Our manufacturing industries are operating at no more than 75 percent of capacity—they have a lot of slack to take up before experiencing any strain on their capacity. In such circumstances, it is pernicious nonsense to suggest that measures which increase aggregate demand will in that way have any inflationary effect whatever.

On the contrary, to the extent that prices reflect the costs of production, the proposed measures will on balance make it possible to reduce prices rather than increase them. This is so because an industry operating at only three-quarters of its capacity is of necessity operating inefficiently. Workers engaged in direct production may be laid off, but their idle machines represent a continuing cost which must be spread over fewer units. Maintenance workers and others whose work is only indirectly related to production must frequently be kept on the job, and the ranks of executives, supervisors, technicians, and office workers are rarely touched until the decline in production is well under way. Many overhead costs continue no matter how sharply production is cut.

The consequence of these inexorable economic facts of life is to be seen in the commonly observed fact that when production levels fall, profits usually fall even faster. It is an ironic commentary on the power of economic bigotry that the most reactionary political forces, which normally present themselves as the upholders of the business interest, should in this situation be opposing those measures which most surely promise to restore business profits.

As far as the threat of an inflationary development produced by a cost-price squeeze is concerned, that danger is most present when economic recession leads to falling production which in turn results in really serious increases in cost per unit of production. It is worth noting that in highly price-administered industries, such as automobiles and steel, this situation has in the not-too-distant past led to the phenomenon of price increases in the face of falling demand. Increased demand, by making possible increased production, will remove that pressure on costs. Indeed, at this time an increase in demand which would permit optimum levels of production would probably result in an increase in productive efficiency sufficiently marked that it would in fact justify price cuts in many industries.

The administered price problem

As many studies by the Senate Antitrust and Monopoly Subcommittee and the Joint Economic Committee itself have revealed, the power of a handful of corporations which dominate key industries to administer the prices at which they sell their products, and their tendency to abuse that power, is an inflationary threat which continues to operate in periods of economic recession and economic upturn. Investigation after investigation, in steel, in automobiles, in the drug industry, and in others has revealed a shabby story of prices being forced steadily higher even when such action meant deprivation for consumers, loss of jobs for employees, and sabotage of the economy. One of the tasks which must be accomplished without fail and without too much delay is to find a means of discouraging such irresponsible action.

Three years ago, on behalf of my own union, the UAW, I proposed a solution—along the lines of a bill originally put forward by Senator O'Mahoney—which still seems to me the most hopeful answer to the problem. Very briefly, it calls for the creation of a special governmental agency to hold hearings on proposed price increases by corporations which have substantial power to administer prices in their industries. Any corporation which controls more than a given percentage of sales in any industry—possibly 25 percent—would be required to notify the agency of any proposed price increase, and to testify and to produce all pertinent facts and records at a public hearing before such price increase could be made effective. If the corporation maintained that a wage or other economic demand by a trade union would necessitate a proposed price increase, the union as well as the corporation could be required to attend the hearing and to justify its demands. The agency, however, would have no power to control wages or prices. Its power would be limited to bringing out the facts in the case and making them available for public scrutiny. It is our contention that a public airing of the facts would in the majority of cases be sufficient to restrain unjustifiable increases. In a free society, to the extent that we can discipline private economic decisions and make them socially responsible by the moral suasion of enlightened public opinion—to that extent we minimize the need for Government compulsion.

The problem of investment incentives

In his economic message President Kennedy said:

"Expansion and modernization of the Nation's productive plant is essential to accelerate economic growth and to improve the international competitive position of American industry. Embodying modern research and technology in new facilities will advance productivity, reduce costs, and market new products. Moreover, an early stimulus to business investment will promote recovery and increase employment.

"Among the reforms of the Federal tax system which I expect to propose at a later date is a modification of the income tax laws to provide additional incentives for investment in plant and equipment."

Without attempting to pass judgment in detail on proposals which have yet to be made, we feel obligated to express our grave doubts as to the validity of the economic concepts implied in the above suggestion. The principle being put forward seems to be an unnecessary and unwise concession to the adherents of the discredited "trickle down" theory so well beloved by the previous administration.

We do not believe that the way to encourage investment is through tax concessions to those who already have difficulty in finding investment outlets for their funds. We do believe that the one sure way to encourage investment is to make it profitable, and the surest and most satisfactory way to make investment profitable is to raise the demand for goods and services to a level which requires new investment to supply it.

Essentially, there are two forms of investment in plant and equipment today, although in practice there is considerable overlapping between them. They are investment for expansion and for modernization.

Investment for expansion is investment for the purpose of increasing total productive capacity. In most cases it will also involve utilization of the most advanced technology available at the time, but its primary purpose is to make available an increased supply of goods, presumably because the investor thinks he sees a market for them. Obviously, such investment will take place only if existing productive capacity is believed to be, or about to become, insufficient to meet existing or anticipated demand efficiently. Thus, for example, no amount of incentive in the form of tax rebates is likely to stimulate any substantial expansion of productive capacity in an industry which is operating at only 75 percent of its current capacity—which is about the current average for U.S. manufacturing industries. The road to expansion is obviously by way of increased demand, and if demand is increased to the point where increased productive capacity becomes necessary and profitable to operate, no further incentive should be required to encourage that form of investment.

Investment for modernization is investment for the purpose of increasing productive efficiency without necessarily increasing productive capacity. It is best observed in the common situation where a company builds a new plant with the most modern equipment and at the same time closes down an older, obsolescent plant. It is clear that this form of investment holds out the possibility of economic gain even in a shrinking market, and the offer of an additional tax incentive may well stimulate this kind of investment.

It must be noted, however, that an essential feature of investment solely for purposes of modernization is that it aims to maintain a given volume of production with decreased employment. In a sound and healthy economy, such increases in productive efficiency are highly desirable because they permit increases in the total volume of production. In such an economy, again, however, no special incentive is needed to encourage such investment, for the new equipment is bound to be even more profitable than that which it replaces.

In an economy in deep trouble, such as ours today—an economy which is already suffering from a high level of unemployment—investment which aims merely to maintain existing levels of production with fewer workers is of highly dubious value. It may represent an increase in efficiency for the firm undertaking it, but for the economy as a whole it does not represent even that, since the workers displaced will now have to be supported in idleness.

We emphasize that we are not opposed to improvements in the efficiency of production as such. My own union's record of cooperation in the introduction of such improvements has been amply demonstrated, and recognition of the principle is embodied in the language of many of our contracts. We do suggest, however, that when there are not enough jobs for the workers already available, so-called increases in efficiency which result only in more unemployment are not efficient at all from the overall economic view. Public funds should not be used to encourage investment of this kind. They would be far better used in measures to increase demand, which have the result of immediately and directly stimulating employment, and thus ultimately contribute to a far healthier stimulation of investment based on the need for expansion of productive capacity.

President Kennedy himself recognizes that demand which will press upon capacity is the crucially important incentive to stimulate new investment. In his message, he said:

"Today, most industries have the facilities to produce well above current levels. They lack only customers. As a Nation, we lose not only $30 to $40 billion of production per year. We also lose the vital incentives which capacity operation gives for expansion and modernization of plant and equipment."

We urge that the strengthening of this form of healthy incentive to investment through increases in demand for the products of industry be favored in preference to tax concessions to those who need them least.

One of the most important tools for increasing demand is to enlarge the buying power of low income groups, whose unmet needs guarantee that any increase in their spendable income will be quickly spent. The quickest and most effective means of increasing their buying power is by a substantial reduction in the taxes paid on small incomes. By this means we cannot only stimulate consumer demand, private investment and economic growth, but at the same time take a forward step toward meeting the needs of those whose unmet needs are great.

The extent to which capital investment must depend on consumer demand was expressed in an article entitled, "It's the Consumer's Play Now," published in Business Week on June 27, 1959, when the economy was striving for recovery from an earlier recession. Business Week said:

"Capital spending can't go all the way back to 1956 or 1957 levels without the support of rising consumer demand. That's needed to carry producers up to and beyond their preferred operating rates."

The consumer demand hoped for at that time did not eventuate—and the current recession, including the current decline in capital investment, is the consequence. Today, even more than in 1959, stimulation of aggregate demand is the primary key to the solution of our problems both of production and investment.

At about the same time (on May 16, 1959) Business Week published the results of a McGraw-Hill survey, which showed that in the period 1953–57, manufacturing industries had obtained 61 percent of the cash they spent on new plant and equipment from depreciation allowances, but in the period 1958–62 depreciation allowances would cover 94 percent of manufacturing companies' proposed capital spending.

Although later surveys reduced in some measure the percentage of capital spending expected to be provided from depreciation allowances, events have demonstrated that for some companies in particular this forecast was, if anything, highly conservative. For example, in the period 1958–59, depreciation allowances of General Motors Corp. have amounted to $833.9 million, while in the same period the corporation's expenditures on plant and equipment have amounted to $589.3 million, or only 70.7 percent of the amount available from depreciation.

In the period 1958–59, depreciation allowances of the Ford Motor Co. have amounted to $360.2 million, while its investment in new plant and equipment has amounted to only $164 million, or 45.5 percent of its depreciation allowances.

Obviously, no amount of tax incentive is going to increase the investment spending of these corporations. If such incentives are offered, the corporations will take advantage of them, not to increase their planned investment, but to finance at the taxpayers' expense a portion of what would have been undertaken in any case.

Indeed, offering tax concessions to corporations which already have more funds available than they are prepared to invest at home may only serve to aggravate this country's problem of the international balance of payments. Corporations which cannot find sufficient opportunities for profitable investments in the United States, because of lack of adequate growth in our economy, will seek them abroad, and tax reductions or other concessions can mean simply that they have that much more money to send abroad.

The foreign investment program of the Ford Motor Co. in the past 2 years is a case in point. With over twice as much available from depreciation allowances alone (to say nothing of retained profits) in 1958 and 1959, as it was prepared to invest in U.S. plant and equipment, the Ford Motor Co., in 1959, spent $148 million to buy up privately owned shares in Ford of Canada, and in 1960 it sent $335 million in American dollars to a London bank to pay for shares of Ford of Great Britain.

The way to increase private investment in this country is not to give such companies still more money to ship abroad. It is to increase the demand for products of U.S. plants so that further expansion of our productive capacity will once more become attractive.

A program for balanced economic growth

The lack of balance between the economy's ability to produce and actual demand has become increasingly serious in the past 8 years. Top-heavy emphasis on business investment in new plants and equipment in the mid-1950's—after Federal expenditures were cut and while consumer spending for hard goods lagged—was a major factor in the 1957–58 recession. Continued, inadequate attention to levels of Federal Government and consumer expenditures has contributed to the present general decline.

Business investment has shot forward at various times during the 1950's, but it has lacked the kind of sustained and rising demand for goods and services that is necessary to keep it moving forward, without perilously frequent declines.

It is essential for economic progress in the 1960's to view business investment in new plants and machines in proper perspective. If Government and consumer spending, in combination, continue to lag considerably behind the economy's productive potential, frequently recurring recessions and rising unemployment will persist.

Business investment demand is in the main derived demand, dependent upon the level of consumer and public demand. As pointed out in the report of the Senate Special Committee on Unemployment Problems:

"The surest way of encouraging private investment is to increase the demand for goods and services to the point at which it challenges industry's capacity to produce."

In pursuing the objectives of full employment and balanced economic growth, the Council of Economic Advisers should project the levels of consumer spending, private and public investment, and other Government expenditures that are necessary to sustain maximum use of manpower and productive capacity in an expanding economy. Long-range projections, based on probable manpower and productivity trends and national needs, can indicate the general direction which economic policies should take, for the national economy as a whole and for its major sectors. Annual presentation of economic targets—with semiannual reviews—can provide private groups and government with guidelines for policy decisions.

The perspective gained by such projections could lead to measures that will assure a much improved interrelationship between the economy's ability to produce and the demand for goods and services, as well as between private and public expenditures.

At present, short-range projections can indicate the policies that are needed to readjust an unbalanced economy. The long-run needs of a dynamic economic system, over the period of a decade, will differ from the urgent requirements of the present and the next few years. After the economy has moved forward—with adequate balance and maximum growth—continued projections of economic targets may indicate the need for possible shifts in emphasis among private consumption, private and public investment, and other Government expenditures.

In such a continuing effort, the Council of Economic Advisers can provide all sectors of the American economy with guidelines for decisions that can sustain full employment and balanced growth.

The present need for a substantial increase in the level of demand gives us an opportunity to quicken our approach to eliminating the great gaps in public services and social welfare.

Increased Government expenditures to meet our needs for more adequate public services, improved social welfare programs, increased international economic aid and more adequate national defense, together with measures to increase consumer purchasing power, will provide the enlarged demand that creates incentives for high and rising levels of private investment.

Although these programs are essential in any event, it is especially important at present to put them into effect quickly in order to restore the economy as rapidly as possible to full employment and healthy growth. As the President stated, "Fortunately, the measures to overcome recession, to take up the slack, and to speed growth all reinforce each other."

Except for the doubts and reservations noted above regarding tax incentives intended to stimulate private investment, we support the program for the promotion of economic growth and price stability outlined by the President in broad terms in his economic message presented last week. We believe with him that we can and must accelerate economic growth by investing in human resources—by strengthening education, health, research, and training activities. We agree that growth must be promoted also by the various types of investment in natural resources listed by the President. We share his conviction that the tripartite Advisory Committee on Labor-Management Policy which he proposes to create can and will contribute constructively to the formulation of sound policies in the broad national interest on a wide range of issues. The creation of such a committee is especially important at this time when we are confronted with the complex human and economic adjustment problems arising out of automation and accelerated technological change in general.

Among the specific measures which we believe are essential to balanced and vigorous economic growth, in addition to those included in, or mentioned above in connection with the President's 12-point recovery program are:

1. *Growth target.*—Full employment and full utilization of resources can give us a growth rate of 5 percent. Balanced economic growth averaging at least that rate 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 at an average annual rate of 5 percent.

2. *Aid to education.*—Federal aid for school construction and teachers' salaries should have top priority.

3. *Medical care for the aged.*—Medical care for the aged should be provided through the social security system, without further delay.

4. *Housing.*—A comprehensive Federal program of low-cost, low-rent public housing and middle-income private housing is needed. College housing and housing for the elderly must also be given adequate attention.

5. *Urban renewal.*—A comprehensive program of urban renewal and industrial rehabilitation to remove the blight of city slum areas and rebuild urban centers is badly needed.

6. *Community facilities.*—An adequate community facilities program to enable cities and towns to provide adequate sewage disposal plants, sewage lines, power facilities, cultural and recreational facilities, hospitals and nursing homes, roads, streets, mass transportation, and other essential facilities.

7. *Government contracts for distressed communities.*—One of the most obvious ways in which the Federal Government can give immediate aid to communities distressed with serious unemployment is by placing defense and other Government contracts in such areas. Such action will not only help to relieve the distress in these areas, but by insuring that the work is done by men and women who would otherwise be idle, it will make a contribution to the Nation's economic growth. The new administration has already made a start in that direction by way of Executive order, but to do the job effectively will require legislative action. Legislation should recognize the principle that reasonable additional costs involved in placing contracts in distressed areas will be offset by resultant avoidance of the heavy financial costs and other tragic consequences of unemployment, both to such communities and to the Nation.

8. *Public works shelf.*—A comprehensive, national shelf of deferrable Federal, State, and local government public works programs should be established now, to be put into operation promptly if another recession starts. Such quick action, at the very beginning of a general decline, would stimulate the demand for construction materials and would increase job opportunities both on and off construction sites.

9. *Resource conservation and development.*—A program to conserve and develop our natural resources, including the items listed by the President, should be undertaken. The neglect of recent years has made the need greater and more immediate.

10. *Youth Conservation Corps.*—Unemployed young people should be offered work in a Youth Conservation Corps to work on needed conservation projects. The object of the program should be to give young people the opportunity to become valued and self-respecting members of society by contributing to the conservation of essential natural resources, earning fair wages, and learning skills which will help them to find permanent employment.

11. *Farm program.*—Although farm families have been diminishing in number, they nevertheless account for a significant proportion of total consumer demand as well as demand for agricultural capital goods. An effective and rational program to raise incomes of family farm operations is an essential element of an economic growth program. We believe the Brannan plan approach deserves serious consideration for this purpose although we recognize that our Nation's farm program should be developed in close consultation with the farmers themselves. In addition, efforts should be made through the rural redevelopment provisions of general area redevelopment legislation, as well as through other means, to increase the incomes of marginal farmers by enhancing their on-farm productivity and their off-farm employment opportunities.

12. *Increased consumer purchasing power through higher wages and salaries.*—Many of the measures discussed elsewhere in this statement are designed to raise consumer purchasing power directly or indirectly. This is essential if we are to correct the existing imbalance between capacity and demand. By far the largest single source of personal income, from which consumer demand derives, is employment income—wages and salaries—which accounts for 70 percent of the total. If recovery and balanced growth are to be attained, Government must apply policies calculated to right the existing imbalance and thereafter to encourage the movement of wages parallel with the growth of our ability to produce.

This requires, among other things, that free collective bargaining be unleashed from the legislative shackles that now hamper unions in the effective performance of the role they should play in a free economy. Revision of our labor relations legislation should be aimed at returning to the Wagner Act policy of active encouragement of collective bargaining as contrasted to present legislative policy which, at best, grudgingly tolerates unions and imposes unnecessary and unjustifiable obstacles both to the organization of unorganized workers and to effective collective bargaining.

Through vigorous applications of the Walsh-Healey Act, the Government can use the powerful leverage of its vast procurement operations to raise the general level of wages by bringing substandard wages up to the levels generally prevailing in industries working on Government contracts. The act should be amended to the extent necessary to assure its quick and effective implementation and ample administrative funds should be provided to permit frequent review of prevailing minimum wage-determinations in order to keep them fully up to date.

13. *Reduction of the workweek.*—Standard working hours under the Fair Labor Standards Act should be reduced gradually, with no reduction of take-home pay, as technological change accelerates and productivity rises.

14. *Fair employment practices and action against discrimination.*—Opportunities should be opened for members of minority groups to contribute fully and to share fairly in social and economic progress through enactment of Federal fair employment practices legislation. In addition, the President should make the fullest possible use of his Executive powers in support of civil rights and to fight segregation and other forms of discrimination in education, housing, and public accommodation.

15. *Administered prices.*—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 and Monopoly—to provide the basic facts and knowledge for developing possible remedies for abuses 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 sector of the economy should be closely examined for the possible development of opportunities to reduce prices, whether because of improvement productive efficiency or for other reasons.

16. *Economic aid.*—Economic aid and technical aid for the peoples that are emerging from colonialism should be considered a major aspect of national policy. Such programs of loans and grants—both directly and through international agencies—should be greatly expanded as part of a long-term effort to assist the economically underdeveloped nations, and the United States should make every effort to enlist increased support for that effort on the part of other nations that can afford to share in it, as well as increasing our own country's contribution.

17. *National defense.*—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. Waste and duplication should be eliminated and defense expenditures should be raised, if necessary to provide adequate national defense.

18. *Research.*—The Federal Government should encourage the development of both basic scientific research and technological application. Adaptation of the great advances in military technology to civilian purposes should be speeded up. Industries of low and slowly rising productivity should be assisted to improve technology, while other Government programs operate to cushion any adverse impact of rapid technological change on individuals, businesses, and communities. Development of atomic energy for peaceful purposes should be given high priority. Cooperation with other nations should be sought in peaceful programs of worldwide importance such as desalination of water, advances in meteorology and the exploration of space.

19. *Clearinghouse on technological change.*—This committee of the Congress has made a start in investigation of the social and economic effects of automation and rapid technological change in general. The committee is to be commended for its recent publication updating testimony on the subject taken in hearings some years ago.

The Advisory Committee on Labor-Management Policy which President Kennedy proposes to create offers hope of becoming an important source of policy to deal with the adjustment problems arising out of accelerated technological advance. If that Committee and the various agencies of government concerned are to perform their functions effectively, however, they will need a far wider range of information than is presently available on the subject.

We therefore urge the establishment of a government clearinghouse on technological change to gather and evaluate information on a continuing basis on developments in automation, atomic and solar energy, new materials and other technological innovations and their actual and prospective impact on employment opportunities and the location of industry. Such material, if made available to the President's advisory committee, the Council of Economic Advisers and other appropriate Government agencies, would be invaluable in the formation of policies designed to assure that the fruits of technological advance are fairly shared, that personal and community hardships and dislocations are minimized, that full employment is maintained, and that adequate economic growth is achieved. The information obtainable from such a clearinghouse would also provide the basis for periodic review of the standard workweek in relation to changing technology.

20. *International trade.*—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 for our own products. We must work to lower some of the barriers which have recently been raised against our exports, while resisting the temptation to retaliate with higher barriers against imports. But we cannot avoid the problem of unfair competition with some American products from low-wage, highly efficient foreign producers. To help solve this problem for all exporting countries which face it, the United States should propose through GATT and the International Labor Organization the establishment of international fair labor standards provisions on wages and other labor conditions in export industries, directed at raising wages in such industries step by step to levels justified by productivity.

21. *Monetary policy and the Federal Reserve Board.*—We welcome the President's announcement that measures are already underway to increase the flow of funds at declining long-term interest rates. While, in view of the outflow of gold, short-term interest rates must for the time being be maintained, we should set as our objective, to be achieved as quickly as practicable, a monetary policy conducive to vigorous economic growth. This requires abandonment of the "bills only" or "bills usually" policy.

An adequately expanding money supply at reasonable interest rates is essential to healthy growth. This has been denied the Nation in recent years in part because of the unrepresentative character of those who set Federal Reserve policy. 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 system which is now dominated by the viewpoint of bankers and big business.

22. *Tax reform.*—The Federal tax structure should be reformed and overhauled to provide a balanced and equitable basis for raising needed Federal revenues. Recent erosions have weakened the progressive tax structures, originally intended by the law, and have contributed to the lack of balance between the economy's ability to produce and actual sales.

Once full employment is achieved, the reformed tax structure could provide the additional revenue necesary for enlarged Federal spending. It is true that existing rates will yield substantial revenue increases if adequate economic growth is achieved. This may be sufficient to more than balance the budget during periods of high levels of employment and production. However, the task of overhauling and reforming the tax structure should not be avoided. Reestablishment of equity in the tax structure may make it possible to avoid tax increases in the years ahead, possibly to retire some of the public debt, and perhaps to permit some tax reduction.

Reform of the tax structure should be based on fairness and economic balance. Some tax assistance should be afforded, for example, to small business, which usually suffers disproportionately in terms of economic stress. This assistance could take the form of reversing the present 30 percent normal and 22 percent surtax rates on corporate income. The lower 22 percent rate would thereby apply to smaller corporations, instead of the 30 percent rate as at present, and the current 52 percent tax rate would remain for larger corporations.

The proposal to afford special consideration and special tax reductions or concessions for all corporate income should be resisted strongly. Business investment in new plants and machines will not be aided, on a sustained basis, by grants of special privilege. A sound and sustained rise of business investment requires economic balance, rising demand and the expectation of continued increases in sales volume and profits.

Conclusion

The task before us in a tremendous one—that of restimulating and restoring to health an economy which for nearly 8 years has been weak and halting. It will not be accomplished in a few months. But the prospect before us is neither gloomy nor grim. For the task we face has one highly satisfying feature—the fact that every forward step we take will bring with it a measure of immediate accomplishment.

The new administration's first Executive order, increasing the distribution of surplus foods among needy families, not only meant that a little progress had been made toward clearing away the surpluses that have been piling up in costly and unfruitful storage, but it meant also that the empty bellies of hungry men, women, and children were to be a little more adequately filled.

Immediate improvement in benefits for the unemployed and their continuation through adoption of permanent Federal minimum standards will not only help to stimulate business by adding to the volume of consumer buying power where it will be most rapidly put into circulation, and help to prevent future recessions by permanently strengthening this most essential built-in stabilizer of our economy, but it will mean also an immediate relief from hardship and a lifting of morale and confidence in the future for millions of men and women.

Programs to speed the building of homes, schools, hospitals, highways, and community facilities will not only provide jobs for unemployed workers, but they will help to fill the gap between our growing social needs and the inadequate provision that has been made for them.

The restoration of our economy to those conditions of maximum employment, production, and purchasing power called for by the employment act will take time, and that time will be lengthened if every forward step has to be taken in the face of partisan opposition and reactionary prejudice. But the task can and will and must be done. With confidence in ourselves, faith in our fellow men and a vision of the world that we can help to build, we believe that to us in given the opportunity and the responsibility to prove that freemen, living in a free society, can build a better and a stronger and a happier world, with less of human suffering and more of human justice and freedom and opportunity than men have ever known before.

Mr. REUTHER. We are deeply troubled because at a time when there are tremendous unmet needs in America in terms of living standards and schools and housing and roads and resource developments, at a time when there is so much work to be done, at a time when we, as the strongest of the free nations of the world, must accept increasing responsibilities in the world, at this very critical period our economy is in low gear.

Twenty-five percent of our total productive capacity stands idle today; 5.4 million workers are totally unemployed, which represents 6.6 percent of the work force, but this is only part of the unemployment picture.

There are millions of other workers not included in these figures who are working part-time, short workweeks. There are 173 distressed areas plagued by unemployment. The unemployment situation in those areas has reached desperate proportions, with the total unemployment running anywhere from 6 percent to in excess of 20 percent.

Now, this is where we are at a time when there is much work to be done in the world. We believe that Congress must address itself to trying to find a way, doing what it can, to get the American economy back in high gear so that we can have the abundance of full employment and full production to meet our needs at home and to make America equal to the challenging and compelling responsibilities we face in the world.

I have said many times, Mr. Chairman, that I, as one American, believe that the American economy is freedom's greatest material asset, and that if we can use this economy intelligently and with a sense of social and moral responsibility, it offers the economic potential by which we can meet the problems of the American people. We can raise our living standards, we can give our children broader educational opportunities, we can give our older people a more secure and dignified life in the autumn of their years, we can do all the things we need, wiping out the slums and taking care of the basic needs of America.

We can do all of these things and at the same time we can devote increasing economic resources to meet the responsibilities that we have in the world. I, personally, despite the difficulty that we now have, am confident that our system of freedom can be made to work and only as we make it work will it be equal to the challenge.

Now, I happen to believe, as one American, that we are in trouble not because there is anything fundamentally wrong with our system of freedom, or that there is anything wrong with the values around which we have built that system of freedom. I believe that we are in trouble because we are not trying, and I propose that it is high time that America recognize that you cannot win the world contest if you make it a part-time endeavor.

I have told the people that I represent, "You know, this contest between freedom and tyranny is a one-game world series; there are no return matches; you either win it or you lose for keeps."

We are not doing as well as we need to do to meet our needs at home and to be equal to the challenge in the world.

Here is an illustration of how badly we are doing. Here is the Wall Street Journal, Tuesday, February 7, 2 days ago. The headline says, "Week's Steel Output Is the Lowest for the Month of January in 15 Years." This is where we are: the lowest production in 15 years in a basic industry like steel.

A few months back we used less than 50 percent of the productive capacity of the steeel industry.

Mr. Khrushchev is looking at America. I met with him for almost 4½ hours in San Francisco when he was here last year. We saw him in the U.N. He is crude, he is cocky, and he is confident because he looks at the steel industry in America and he says, "I can beat these fellows because they are not trying."

Look at the fact that last week the steel industry operated at 51.9 percent of its total productive capacity. It produced 1,492,000 tons of steel, and it had an idle capacity equal to 1,383,000 tons.

The Soviet Union, based upon its average weekly production last year, had a smaller total steel productive capability than we had idle plants standing there not being used in the American steel industry.

Anyone who understands the dimension of the world challenge must ask himself how we can win, how our system of freedom can be made equal to the complex and difficult challenges we face, when we have a larger percentage of steel production standing idle than the Soviet Union has in terms of its total capability.

I want to say it is encouraging and heartwarming to find that the President of these United States, in only a very brief period in office, has issued the call to action, has called upon America to dispel the smugness of complacency and to recognize the dimensions of the problems we have at home and the challenge we face in the world.

I think in this brief period he has given America a greater sense of urgency, a clearer sense of national direction, and, I think, a deeper sense of national purpose. It is the responsibility of all Americans, whether they are from labor, management, agriculture, whether they are Republicans or Democrats, of all of us somehow to achieve in this crisis the same sense of unity and the same singleness of purpose that we demonstrated in the crisis after Pearl Harbor, because the challenge we face today is equally grave. Yet it is much more difficult to mobilize a free people to face this less tangible threat than it is to mobilize them when they are confronted with a challenge such as we faced in the dark days after Pearl Harbor.

The President has suggested in his state of the Union message that we must overcome the years of economic stagnation and drift and neglect and that we must achieve a dynamic expanding growth in our economy so that we have full employment and full production, so that we can harness the potential abundance of the new science and technology that is being fed into the economic stream.

I believe that both the executive and the legislative branches of our Government have a joint responsibility and I would urge that they cooperate and that they rise above partisan differences, recognize that the hour is late, that the challenge is great, that the stakes are the highest that free men have ever been called upon to defend, and that we meet this challenge on the home front with the same vigor and determination with which we meet the challenge on the world front. Only as we meet the challenge at home can we meet the challenge in the world.

These are not separate compartments; they are bound together. Only an America that is fully mobilized, with a full-employment, full-production economy, that puts this 25 percent idle capacity back to work, that puts the millions of unemployed workers who walk the street back to work, only that kind of America will be equal to the test that we face.

I think the practical job that you face in Congress, and the executive branch of the Government faces together with you, is to take those steps that are necessary to implement the spirit and the purpose of the Employment Act of 1946, which committed this Nation as a matter of national policy to doing those things that must be done in order to maintain high levels of employment, production, and purchasing power.

This is a declared matter of national policy. We should not debate this. Our concern ought to be what can we do to achieve most effectively those purposes as set forth in the Employment Act of 1946.

The President, with great eloquence and great economic truth, stated in his state of the Union message, "The Nation cannot afford and will not be satisfied with economic decline or stagnation." We all support these sentiments.

Then he went on to say, "Our program must aim at expanding America's productive capacity at a rate that will show the world the vigor and the vitality of our free economy."

These are not merely fond hopes; they are realistic goals. I should like to suggest that we add "They are also compelling necessities if we are to be equal to the challenge that history has placed upon our shoulders."

We did not ask for this responsibility. We would have been quite happy and quite comfortable to have gone on our way as a Nation not burdened by the heavy responsibilities of world leadership. But we are the only country in the world that has the essential ingredients to world leadership. The Germans haven't got it. They have economic resources, but they do not have the rich democratic heritage. The British have the heritage and not the resources.

We alone have this rare combination of a tremendous productive potential, of great economic resources, and a rich democratic heritage to give the use of these resources a sense of direction, a sense of social and moral purpose.

This is why we have to assume an increasing share of the responsibility for the future of human freedom, and we cannot do that if we are only half-trying. We cannot do that with 25 percent of the tools that we need to be working with standing idle.

I have been suggesting that this unused capacity, these idle hands and idle machines all over America, represent more than the margin of economic progress, of our ability to improve the economic well-being of people generally in this day.

In this day and age they are the margin of survival of the values we hold dear. I believe that we are on trial not only in terms of history, but in terms of the people of the world. They are looking at us and they are saying to themselves in Asia, and I have been there and talked to them, in Africa, Latin America. "Look at the United States. It is more richly blessed than any country in the world. It has all the resources, human material, skilled manpower, highly developed technology, productive economy; it has everything it takes in the way of tools to solve the basic economic and social problems of a society, and yet there is something wrong because with all of these resources America somehow has not found a way to relate the resources to basic human needs."

Now, you can have all the Voice of America programs you want, you can step it up to the highest kilowatts you can get in the way of transmitters, but you must always remember it is the power of the democratic deed that penetrates the dark places of the world where men are searching for answers. It is not the propaganda of the word.

When we fail in terms of deeds, we begin to destroy our image in the world. We are in a contest with Mr. Khrushchev and his Communist agents all over the world. They are saying that American capitalism, that our free enterprise system, will not work except in terms of war, that we have full employment and full production and overtime and labor shortages only in wartime. They say that is why the men in Wall Street are warmongers, that this economy has not been able to find a way to achieve and maintain full employment and full production in terms of the peacetime needs of the people.

Mr. Khrushchev can wave these Wall Street Journal stories and interpret them for people all over the world. We give them, by our failures, enough ammunition to make their propaganda effective.

It is time we do the kind of job that America is capable of, so that we can take this propaganda weapon away from them and prove that our free system can meet this problem.

Let us not delude ourselves. We all went through the inaugural ceremony a few weeks ago. It is a great human experience to see this whole process of a free society making a shift in power. In the whole history of the human family there has been nothing like it, but let us not delude ourselves into believing that this system of ours, just because it is right morally, is going to prevail against the force of evil.

What shall we do about automation and how shall we find a way to use it sanely and sensibly and responsibly in terms of basic human needs, in terms of education and medical care and housing and all these other things? These are the crucial questions that we have not found answers to. Until we do, we are only pretending we are working at this problem.

We have to work at this thing and work at it harder than we have ever worked at it before, because the people of the world are not going to measure us by what we have. Oh, they are much impressed by this. They are impressed by our plumbing. They are impressed by the other things that are reflected by our industrial indexes, but they will judge us not by what we have, but by what we do with what we have.

It is not your technological progress, it is not your material wealth. It is how you create within the framework of a free society the essential social, economic and political mechanisms so that within the framework of freedom you can solve basic problems and expand the opportunities for greater human growth and fulfillment. This is what counts.

When you look at America, at the slums, at the deficits in education and in medical care, and then at the idle tools, the idle manpower, the idle resources, no American in good conscience can escape the conclusion that we are not doing well and that we must do better.

So long as we do not do better, the people of the world who are undecided which road they will travel are going to have their doubts about whether a system of freedom can solve these basic problems. This is what this fight is all about. The H bomb will not solve it. The ballistic missile, even though the range and payload may be stepped up considerably, is a negative aspect of this contest. We need to have them, but they will not convince one hungry peasant in Asia that our system is superior to the Communist or one dispossessed worker in Latin America or any other country.

We have to recognize these things. We have had three recessions in 8 years. In the past week in Detroit these were the headlines, "75,000 Additional Workers Will Be Laid Off." Now, what happens when 75,000 automobile workers get laid off in the automobile plants of America? That is not an isolated economic fact; you can't put a wall around it and keep it from contaminating the rest of the economy.

The layoff of 75,000 automobile workers has broad economic ramifications. Thousands of steelworkers get laid off because if automobile workers are not making automobiles, they are not consuming steel. Rubber workers get laid off. Plate glass workers, textile workers, electrical workers and workers in hundreds of other industries that feed the automotive industry lose jobs.

Unemployment begins to breed more unemployment. This is why we need action. The snowball rolling down the steep slope not only gets bigger, it picks up speed. The longer you wait, the more momentum you have to stop. The sooner you move the smaller the snowball will be when you deal with it and the lesser momentum it will have and, therefore, the more easily it will respond to positive influence.

Now, I say to the workers that I represent, and I think I speak the sentiments of all workers in America, I do not think you will find 1 in 10 million Americans who believes that each wage earner is automatically entitled to economic security. I don't think economic security is a basic right.

But we do insist the right to a job in order to earn economic security is a right that every citizen is entitled to. When there are economic forces beyond his control, then society must accept the responsibility for those forces and protect the wage earner and his family against forces beyond his control.

Getting America back to work, Mr. Chairman, is not going to get easier. It is going to get more difficult. The nature of the problem tells us that it was difficult yesterday, it is more difficult today, it will be still more difficult tomorrow, because of the tremendous technological progress that we are making and because of the growth in the labor force.

I sat before this committee last year, on the 4th of February to be exact, and I said then that we were getting into trouble.

There were people who were a bit unkind and they said I was a prophet of doom and gloom, but we deal with the bread-and-butter problems of millions of American wage earners and we have learned that there is no such thing as security for them in a vacuum. The only way they can have security, the only way they can make progress is if they share in the general progress of the whole community.

We looked at the whole community and we said there were certain economic factors that were in our opinion very, very troublesome and unless we dealt with those economic factors adequately they were going to plague us with unemployment. I should like the record to indicate, Mr. Chairman, that we gave that warning, not because we had any crystal ball, but simply because it was a matter of evaluating basic economic data and doing it objectively and getting the wishful thinking out of the economics.

Economic problems are very stubborn, they will not yield to wishful thinking. They won't yield to propaganda either. They will yield only to intelligent rational, economic action.

We called for that action last year and we did not get that action. We said that, based upon what we saw in the economic future—this was 1 year ago—that we would have a recession by 1961 or earlier.

We get no consolation from being able to say we told you so.

I raise this now, Mr. Chairman, and I should like to have this put in the record, if I might.

The CHAIRMAN. It may be inserted in the record at this point.

(The material referred to follows:)

PREDICTIONS MADE IN LAST YEAR'S TESTIMONY BORNE OUT BY EVENTS

The following points were made in last year's statement to Joint Economic Committee:

"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 * * *. Rebuilding of inventories * * * provides no basis whatsoever 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."

"* * * unless there are vigorous and immediate changes made in our national economic policies, we shall soon be staggering into a third recession" ("Third" here means third under Eisenhower policies.)

"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."

"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."

"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." (Here we were overly conservative on timing, predicting the onset of the recession for 1961 rather than 1960.)

"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." (Here, again, we were conservative. Unemployment during 1960 actually averaged 5.6 percent of the labor force.)

Mr. REUTHER. I raise this not because we feel proud of this fact; I raise it now because again I am hearing the voices of people who say: "Let's go real easy and maybe this thing will go away. Let's make a halfway try. Let's wait and see."

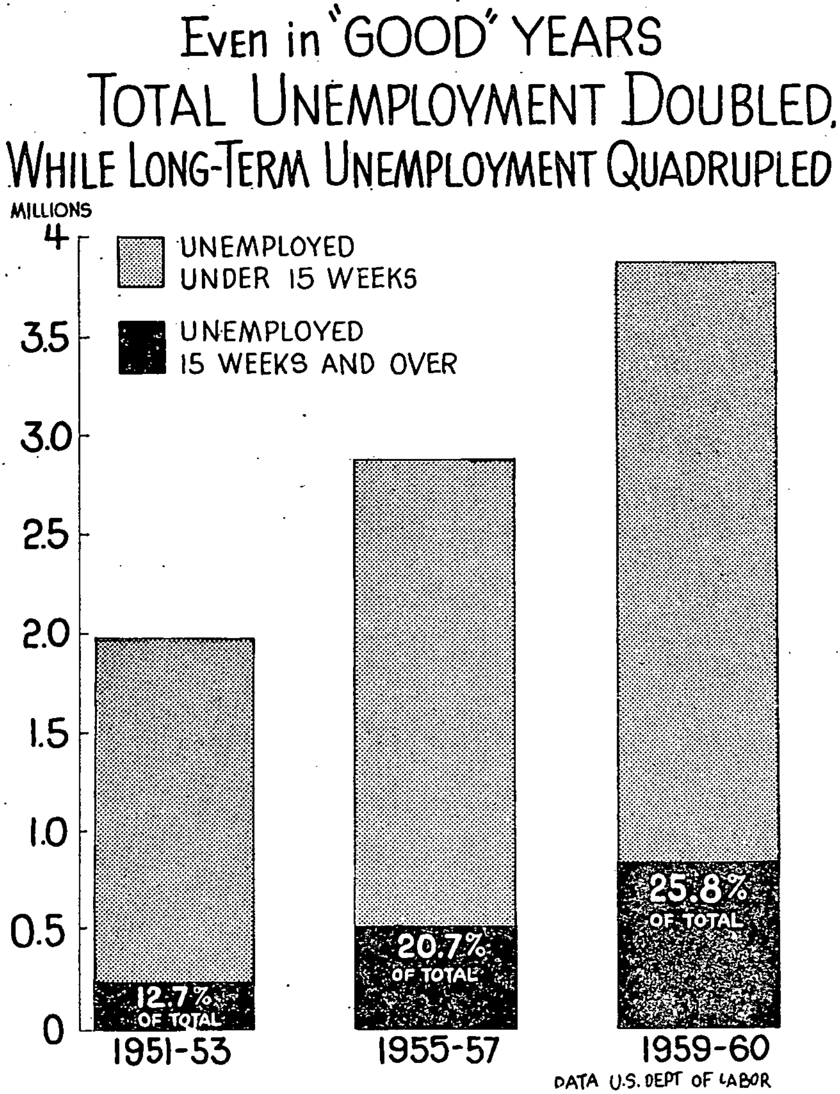
I tell you that this recession will not go away excepting as we meet the dimensions of the problem with action comparable to those dimensions.

All of the wishful thinking in the world, no matter how well motivated, no matter how noble, will not in the face of inaction, bring about a basic correction of the economic situation.

And if the recession is permitted to run its course because of inadequate activity on the part of both branches of the Government, then this time next year, Mr. Chairman, we will be meeting again and the charts on unemployment which I will present if I have the privilege again of appearing, will tell you then, as they tell you now, as we said a year ago would be the case, that the levels of unemployment will be very high and the idle capacity will still be rusting for lack of use.

I would like to point out briefly the dimensions of this problem because only as we comprehend the dimensions of the problem can we begin to develop appropriate action.

Here is a chart that we have put together to show you what happened in the good years—not the bad years, not 1954, 1958, the recession years, but the good years.



You take 1951–53. We had in total unemployment in that period 1,967,000 and we had what we call long-term unemployment of 12.7 percent of the total unemployment, or 249,000 workers who fell into the category of extended unemployment, 15 weeks or more.

Then we take 1955 to 1957, two other "good" years, and we find that the overall level of unemployment went up to 2,887,000, but chronic unemployment, long-term unemployment, went up to 20.7 percent, to 599,000.

Then you take 1959 and 1960, which are supposed to have been, according to what I read, good years. Overall unemployment went up 3,872,000, but the amount of long-term unemployment increased to

25.8 percent, or 998,000—four times as great as it was in the earlier period.

So you see what is happening in even the good years. What is happening is that we are building higher and higher plateaus of unemployment as a permanent factor in our economy in the good years, and the level of chronic unemployment gets higher and higher, being increased 300 percent in that very short time period.

We can only ignore this kind of basic economic fact at great peril to the future of our great country.

I point these things out so that we can see what is going on.

This second chart relates to the same problem. It shows you what is happening in the manufacturing industries.

This shows you the impact of the technological revolution.

That does not wait for us. You can wait to take action in Congress, but the technological revolution waits for no man. It moves on at an accelerated rate; it picks up more momentum every day.

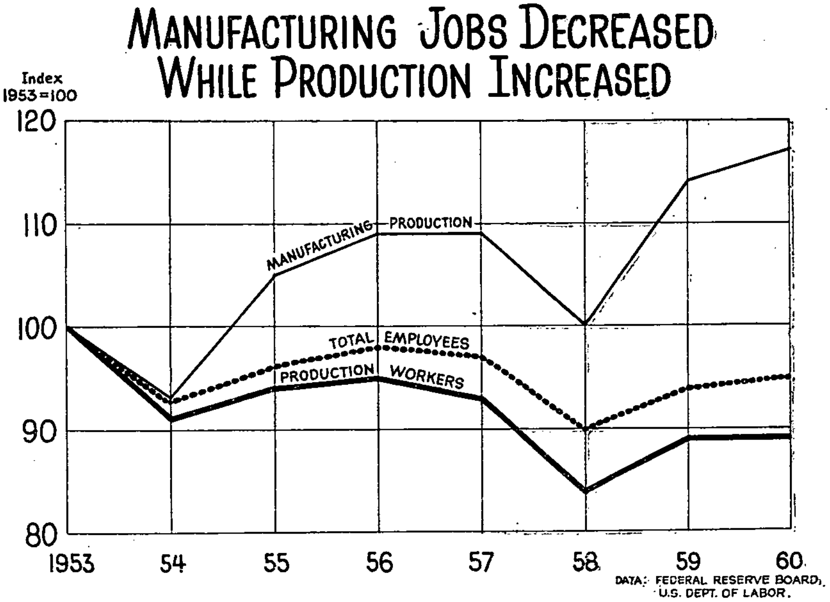
That is its nature. It feeds on itself.

This shows you what happened. This top line is manufacturing production. You can see what has happened to it.

It went up 17 percent from 1953 to 1960. The output of these plants increased that amount.

Total employment, in production, maintenance, and white-collar clerical, went down.

While production went up 17 percent the number of jobs went down 900,000.

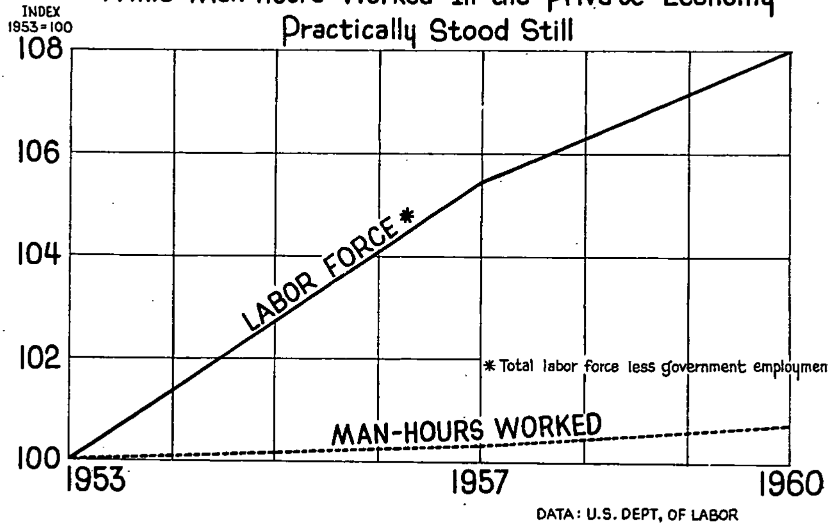


When you take account just of production workers, you find that while production went up 17 percent in that period the number of manufacturing jobs went down 1,600,000.

But this is nothing compared to what is going to happen in the next 10 years. Production is going to be up and the line reflecting employment is going to make a sharp drop unless we adopt programs for full employment. These are the dimensions of this problem and we have to meet them.

This next chart bears on the same aspect of this basic economic problem. This is what is happening to the work force. It increased roughly 8 percent from 1953 to 1960.

Between 1953 and 1960 The Number of Workers* Increased by 8 Percent While Man Hours Worked In the Private Economy Practically Stood Still



But the number of man-hours worked in the private sector of our economy has almost been stationary.

Now, it is this gap and the gap in those other charts that has to be filled. How do you fill it? You can only fill it by creating the kind of economic growth and expansion that will create full employment, that will create job opportunities.

But here, again, we don't comprehend the great number of jobs we need to create. This is one of the problems in statistics. You can get lost in a kind of wilderness. You can be so overwhelmed you don't understand it.

So I have tried to put this down in simple arithmetic. In the next 10 years it is projected there will be an increase in our total work force of roughly 13½ million new workers, or 1,350,000 a year.

To take care of those new workers, we will need an average of 26,000 new jobs every week, with no vacations.

This chart shows that production went up 17 percent but the number of manufacturing jobs went down 1.6 million in that short period. It shows some of the effect of the increase in productivity. If productivity advances were not held back by economic stagnation, we would need to find more than 2.8 million new jobs a year or 54,000 new jobs a week for workers displaced by improved technology.

So that if you take the new jobs we need for new workers and the new jobs we need for workers displaced because of technological progress, we need more than 80,000 jobs every week in the year.

That is just to hold our own. We have to do better than that to catch up, to get rid of the backlog of unemployment.

Well, 80,000 jobs a week, again that is hard to visualize. General Motors Corp., which is the largest corporation in the world, has roughly 400,000 employees in the United States, not counting their foreign establishments. Eighty thousand jobs a week means that every 5 weeks we have to create as many jobs as there are workers employed in the United States of America by General Motors Corp., 400,000 every 5 weeks.

Every 3 weeks we have to create jobs for the equivalent of the General Electric Co.'s 240,000 workers; every 2½ weeks the job equivalent of the 200,000 employees of United States Steel.

Every week we have to create the job equivalent of the total U.S. employment, factory, clerical, and professional, of the Dupont Co., the biggest chemical industry in the world.

Now, this gives us some concept of what we are dealing with.

People should not pretend that this kind of problem will go away with a little bit of sweetening on the fringes. It is not a matter of whether or not good people want to do the right thing; it is a question of whether they understand the dimensions of the problem we are dealing with, and therefore, come up with answers adequate to meet the dimensions of that problem.

In the period 1947–53, we had an increase in our gross national product of 4.8 percent, per year.

That was the average annual increase.

In the 1953–60 period we only had a 2.4 percent increase per year.

It is this difference that began to accumulate the backlog that now plagues us. It laid the basis for the 1954 recession. It laid the basis for the 1958 recession. It laid the basis for this one.

This will be a continuing problem, until we deal with it.

Now, if you deal with the 1,350,000 additional workers each year and the 54,000 new jobs each week to take care of technological displacement, the only way you can create those 80,000 jobs a week is to have an increase in your growth and your expansion, at a minimum of 5 percent, which would still permit leeway for increased leisure. It is there to be done because if you take the increase in productivity based upon the acceleration of our technology, compounded by the increase in the work force, those two factors together will give you a minimum of 5 percent of economic growth and this is the minimum that we believe the economics, of necessity, dictate in this situation.

Nothing would make me happier than to be able to come here and say to you in all good conscience that there are a number of favorable and encouraging economic signs on the horizon. But I must tell you in all truthfulness that there are no such encouraging signs, that the people who are projecting a short recession are counting heavily on intangible psychological things, they just think it is that way. Some people find it encouraging that some inventories are being depleted and soon, they say, will have to be replenished.

But I suggest, Mr. Chairman, that your committee look at the relationship of inventories to the level of sales. How many days of inventory do you have in terms of sales? This is a relative thing.

Inventories are not absolute, they are relative. You take the automotive industry and here is a story out of the Detroit News dated February 7, 2 days ago. It says, "Inventory rise during January." We now have 1,020,000 new unsold automobiles. Sixty-nine days of sales. Just think of that. More than 2 months' supply based upon the level of sales.

This story goes on to say that sales in January were 19 percent below the sales of January 1960. Now, this is where we are. If the automobile industry were making peanut butter instead of automobiles and you had a 69-day supply of peanut butter on the shelves of American stores, I would not be worried. But the automotive industry is an industry that consumes a larger amount of materials and component parts than any other basic industry, excepting housing.

When that industry is 69 days of sales ahead in inventories and it is laying off 75,000 workers, you can't ignore this, unless you are trying to run away from the problem rather than trying to find a solution.

It is for these compelling reasons, Mr. Chairman, that we urge the Congress to take adequate affirmative action in the many areas where action is demanded to get America back to work.

We need action to implement the emergency program that the President has suggested. I think he has done an excellent job in coming up with the recommendations that he has proposed to deal with the hardships of unemployment. Then we have to get around to the long-range problem. It is not enough just to patch the hole in the roof when it is leaking; we have to do a real job of rebuilding that roof so that it can stand the stress and strains that you can't eliminate completely in a free economy.

We applaud the vigorous action of the President and we support wholeheartedly his 12-point program. It was significant that the first day he was in the White House he recognized that in the midst of the greatest food abundance in the history of human civilization there are hungry people in America and he did a fine thing in expanding the distribution of those food surpluses.

You know, it is hard to believe that in a city like Detroit this kind of headline would be possible in the year 1960. Yet, this is the front page of the Detroit Times of October 12, 1960. It says, "Mother dies after starving 2 months." This woman literally starved to death and her son was living on bread and water. I venture to say there aren't many places in the world were people have gone hungry because the farmers have raised too much to eat. You have to achieve a very high level of human civilization to be able to accomplish that. It is kind of old-fashioned just to go hungry when we don't have enough to eat. But we have hunger in the midst of abundance. This shows that the gears are not meshing properly between the production and distribution parts of our economic machine. We have to do something about that.

We urge that you take prompt action to implement the President's 12-point program, to extend unemployment compensation to meet the problems of hunger and hardship. When you have been out of work more than 15 weeks, your savings get thin. Then you exhaust your unemployment compensation and then what do you have? Public charity. This is not good enough for America. We urge that you enact the recommendations of the President, provide for coverage of the children of the unemployed under the aid-to-dependent-children program; that you expand social security, minimum wage, enact housing, community facilities, distressed area legislation.

And we would urge that the contract placement program be reviewed. We believe that you need legislative authority to place defense contracts effectively in the distressed areas and in the absence of that the President, in our opinion, would not have the kind of authority that he needs.

The President has stated that 75 days from the date of his message, roughly in April, he is going to review the matter of taxation. We believe that the better part of wisdom would be that the Congress now, and with a minimum of delay, enact emergency tax legislation to grant the President standby authority so that if things don't get better by April, if that is when the situation is going to be reevaluated, he will be armed with the necessary authority to move decisively at that point without the further unnecessary and costly delay that the legislative process would require. If at that time he asked for authority to move on the tax front——

Senator Bush. Will you yield for a question there, Mr. Reuther?

Mr. Reuther. Surely.

Senator Bush. Do you think that authority should be granted even though the Congress is in session? In other words, if April 1 was a magic date and the Congress was sitting here, do you still think the President ought to have that authority?

Mr. Reuther. I do, sir, for this reason: Tax legislation is extremely complex. We all know that when you open the tax question there are always groups that raise this point and that point and this can mean delay. We think that at the point that there is justification for action on the tax front, there should be action and not congressional debate.

The Congress could grant standby authority now that would provide for a final resolution approving the action of the President at the critical moment. That would require much less time to process than if you started from scratch.

This is not only my opinion and the opinion of the labor movement in whose behalf I make this recommendation. I would like to quote from Business Week.

No one has ever suggested that this magazine is a propaganda organ of the American labor movement. This piece is dated December 17, 1960, and it bears upon the question of taxation.

I quote from Business Week:

> Under these circumstances it might well make sense to try something new in antirecession strategy: a temporary tax cut to take effect, if necessary, at the discretion of the President. As soon as it comes back Congress could pass the necessary legislation specifying the expiration date, but leaving the starting date open. Kennedy could then begin his term with a weapon in hand to use if the situation began to look critical.

This is precisely what we suggest.

Senator Bush. That would suggest then that the Congress would not be in session. It says, "if necessary."

Mr. Reuther. No, it says as soon as the Congress comes back. It says, "As soon as it comes back Congress could pass." They are talking about right now.

What we have suggested is a possible approach. We raise this merely to indicate what we think is an effective antirecession tool that the Congress ought to give consideration to bringing into being in the event it is needed. We are not proposing its use as of now. We just propose that the tool be there to be used if the situation gets more critical.

By way of example, if you were to waive the first $10 of withholding tax, you would put into the purchasing power stream an additional $350 million per week. Thus you could bring to bear upon the economy the impact of increased purchasing power in order to translate human needs into active demand in the marketplace and put unused capacity and idle workers back to work.

Here again we don't claim any monopoly on the idea. We are quite glad to share it with Business Week and other responsible business spokesmen. Here is a quote from Mr. Theodore O. Yntema. He is the financial vice president of the Ford Motor Co. He testified in 1958 before the Senate Antitrust and Monopoly Subcommittee. Here is what he said during the 1958 recession. I quote Mr. Yntema, vice president of the Ford Motor Co.:

> Don't just reduce taxes; but have a moratorium on the collection of personal income tax or on a part of them if you don't want to do it in the higher brackets, and the depression will vanish like the mist under the sun.

He called it a depression, I only called it a recession.

Senator BUSH. Does he still have a job there?

Mr. REUTHER. I think he has been promoted since he made the statement. Now, we recommend this because we believe that if the situation worsens and we believe that the prospects of its worsening are quite substantial—we wish it were otherwise—the President then would have the tool in hand and we could avoid further delay while the snowball gets bigger and the momentum gets stronger.

We would urge also that, in the implementation of the President's recommendation of unemployment compensation, you not only extend the duration but increase the benefit amounts so that practically all workers could get a minimum of 50 percent of their regular wages. Further than that, we believe it is not enough for Congress, in the 1961 recession, to plug holes. The unemployment compensation system is considered to be our first line of defense against recessions. When the system breaks down twice in a period of 3 years it seems to me that that is a strong indication that something ought to be done about looking at the total problem, bringing the system up to date and making it into a more effective and more adequate first line of defense against recession. We believe that Federal standards are an essential part of making the unemployment compensation system that kind of adequate first-line defense.

On the improvement of social security, we believe that the benefits are inadequate. We think the coverage should be expanded. But we strongly urge that improvement in the basic benefits of the social security system not be regarded as a substitute for a medical care program for the aged under social security. This medical care for the aged is desperately needed.

When you consider that more than half of our aged citizens past the age of 65 have an income of $1,000 or less per year, you can certainly realize, with the cost of living where it is, with the cost of medical care as high as it is, and the cost of drugs, that these people cannot get access to medical care. To subject them to public charity, I think, is to rob them of the dignity to which they are entitled in the autumn of their lives.

In the field of the minimum wage, we urge the $1.25 in one step. We need this high-velocity purchasing power. A worker getting $40 a week who will be moved up to $50 a week is not going to put much of that money in a salt barrel in the basement. He is going to spend that money. We get high-velocity purchasing power by raising minimum wages, by expanding social security, by extending unemployment compensation. It is through high-velocity purchasing power that we can get the strongest impact at the vital point where it is needed.

The housing field has to be gone into. We believe that a reduction in mortgage interest rates from 5¾ to 5½ percent is microscopic. It will not have the impact that the housing industry needs. We would urge that consideration be given to reducing the level of interest rates to 4½ percent because in the long pull the housing industry has the greatest economic potential in terms of sustained economic growth. In that area we have a large unfilled need, and it is going to be an area of great need for a long time because of the growth in population.

We would urge that the Federal Government give consideration to grants to State and local communities to assist in accelerating the public works programs that the States and the communities have worked out. We believe that if you had a $300 million Federal appropriation, it would stimulate $2 billion worth of activities in projects that are ready to go at the community levels.

Now, in the long run, the key, as I said earlier, is growth. In the absence of adequate growth and expansion there are no answers to these problems. We believe that there are a number of problems that we have not understood in America. Take the question of inflation. There has been much more heat than there has been light about inflation. We really have been waging propaganda war against each other, various groups in America, labor, management, other groups. We have done little to enlighten the American people about the real, basic causes of inflation.

I think we have to recognize that one of the problems in our free economy is that as we are dealing with increasingly more productive tools and as the abundance gets greater our problem is to learn to manage it by working out a proper sharing of it among workers, stockholders, farmers, and consumers generally. This is not just a matter of equity, of one fellow getting shortchanged and the other fellow getting more than he was entitled to. It is more important than that. It goes to the very core, the dynamics, of our kind of economy.

In the Soviet Union the commissars meet and they say, "X percent of the gross national product will be allocated to this, X percent to something else," and the worker, the consumer, has nothing to say about it. But in the mechanism of a free economy, unless you work out the relative equities of these basic groups, workers, farmers, consumers, stockholders—I don't care what order you list them in—unless their equities are worked out one in relation to the other and all in terms of the whole, the system won't work.

So this matter of equity is not just a matter of justice. It is a matter of economic necessity, because the minute you begin to feed an inequity into the system, somebody getting too little and somebody too much, you begin to feed the forces of imbalance and those forces eventually acquire enough momentum to get you into a mess.

Therefore, we need to understand how this process works. For example, when we need to build facilities, schools, and so forth, when workers need wage increases, when we need to expand the purchasing power base because our productive capacity is outrunning our consuming capacity, people say, "Oh, but this will feed the fires of inflation." What they have never understood is that the most effective anti-inflationary tool is full employment and full production. If you can turn out more goods than the market is able to consume, that is the most effective anti-inflationary contribution that industry can make.

But when an industry limps along like the steel industry at less than 50 percent of capacity, inflationary forces resulting from high unit overhead costs can do much more damage in that kind of situation than if the steel industry is going in high gear.

Yet people use the inflationary argument as the reason for not doing something that has to be done. I raise this now because there is a new argument on the horizon that we should not be fooled by. It is a very troublesome problem that we need to meet. That is the flow of gold from America. I read the other day that a person in Washington said he was for a higher minimum wage, all the logic and all the equity and all the economics were sound, but he could not see how we could do it because this would accelerate the outflow of gold. I can show you the counterpart some years ago, when they were opposing a higher minimum wage because of inflation.

We should not let this unsound argument block needed economic action.

Now, the key to where we are going, Mr. Chairman, I believe, lies in how we expand production, how we use automation and the tools of abundance. As we mobilize our capability to promote abundance, how shall we utilize our purchasing power to consume that abundance so that in consuming it we can expand and create more, each time achieving economic balance on a higher plateau. This is the key to where we are going.

But when you have 25 percent of capacity unused because there are not enough customers with money to translate need into demand, you obviously need to expand purchasing power. There are a lot of people who say, well, the workers should forego wage increases. We need wage increases because wage increases, as these other things we are talking about, are the source of the expansion of purchasing power.

There is so much propaganda about wages that every time I get a chance I try to help clarify the matter. Mr. C. E. Wilson, who is an old friend of mine from way back, who was the president of General Motors Corp. before he came to Washington, said something back in 1952, when there was a lot of rumbling about wages and prices and inflation, which is worth quoting. In an article in the Reader's Digest Mr. Wilson said, "I contend that we should not say 'the wage-price spiral.' We should say the 'price-wage spiral,' for it is not primarily wages that push up prices; it is primarily prices that pull up wages." That is what the president of the General Motors Corp. said. Because he understood what was happening.

C.E. WILSON Says:

IT IS PRICES THAT PULL UP WAGES. NOT WAGES THAT PUSH UP PRICES.

C.E. Wilson

ral." I contend that we should not say "the *wage*-price spiral." We should say "the *price*-wage spiral." For it is not primarily wages that push up prices. It is primarily prices that *pull* up wages.

walking out. Whe
down, the unions
onstrated their re
abiding by agreem
Arrangements li
and lowering wages in step with the cost of living are commonly called "escalator clauses." They are attacked by people who insist upon talking about "the wage-price spi-

primarily prices that *pull* up wages.

What makes prices? Basically prices are made by the volume of the supply of money as compared with the volume of goods and services

✱ SOURCE.... READER'S DIGEST SEPT. 1952

I believe that we need to give attention, Mr. Chairman, to this whole question. I happen to believe that collective bargaining is not quite adequate to meet some of these problems. I am going to be sitting at the bargaining table in a few months with some of the biggest corporations in the world. I have tried to the best of my limited ability to conduct myself in a responsible manner and I have said many times over, because I believe it, that labor, while it has a separate responsibility to its members, and industry, while it has a separate responsibility to the investors, together have a joint responsibility to the whole of our society which transcends our separate responsibilities.

I believe that collective bargaining decisions must be made in the light of the needs of the whole community. I don't believe that collective bargaining can meet the problems that we have to solve if collective bargaining is just a contest between two economic pressure groups. I think this is what Mr. Khrushchev hopes it will be. He thinks our free society is and will be just a continuous contest between warring groups.

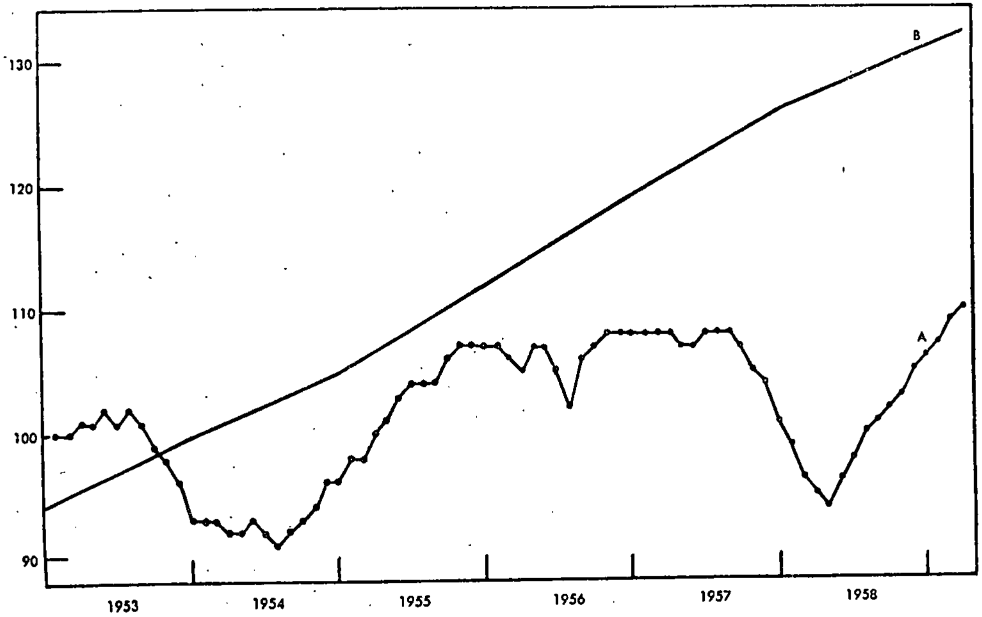
We in the UAW—I don't make this as a recommendation from the whole labor movement—but in the UAW we have suggested, Mr. Chairman, that you ought to explore the possibility of creating a mechanism not to set prices, not to set wages—we would oppose such an effort—but a mechanism—in critical industries and with respect to major corporations and unions whose price and wage decisions can change the general price level in what we call the administered price industries—for public review of price and wage movements which would require both industry and labor publicly to defend their wage and price policies.

I believe that to the extent that we can discipline private economic decisions by making them socially responsible, by making them respond to enlightened public opinion, to that extent we can minimize the need for Government compulsion.

There is another problem that we would like to call to the attention of your committee. That is the question of investment incentives. This has been raised in a general way in the President's state of the Union message. Here again, Mr. Chairman, this is not a matter of economic justice or economic equity between workers and stockholders. This is a matter again that ought to be determined by the economic necessities. If the purchasing power of the American people were greater than the ability of our productive capacity to satisfy it, I would be coming before Congressional committees saying we need tax incentives for industry in order to create the necessary capital to expand our productive facilities, to get a balance with the higher purchasing power. But when 25 percent of our capacity is idle, when the shortage is on the consuming end of the economy, when we lack purchasing power to balance our productive power, then to provide tax incentive for the purpose of expanding industry is most unwise and most unsound and unnecessary.

Here on this chart is an example of what I mean. This top line indicates the projection of productive capacity, manufacturing capacity. This is based on McGraw-Hill and Federal Reserve studies. This chart ends in April of 1959. If you project it, it goes up 9 percent higher—that is the productive capacity. The lower line indicates utilization of capacity. This is what we are doing with it. This has dropped down 1 percent. So if you projected this, this would be down here, this other one would be up here.

Manufacturing Capacity[a] and Production[b] in the United States
(Indices, 1953 = 100)



A = Production
B = Capacity
Source: "Business Plans for New Plant and Equipment", *12th Annual McGraw-Hill Survey*, April, 1959; Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin* (Washington, D. C.).
[a] End of period.
[b] Seasonally adjusted.

To say what we need is tax incentive to expand capacity when we have this tremendous gap between used and unused capacity, I think, is economic unrealism. This is the wrong thing to do.

If purchasing power were up here and capacity were down here, I would be before you urging the kind of tax incentive to get production capacity up where we would need it. But in the face of this it would be, I think, very unsound to provide incentives because what would happen, Mr. Chairman, is that we would not increase the use of productive capacity, we would merely modernize some older plants and more workers would be laid off and you would merely intensify the current economic difficulty.

We have a bulletin here put out by the economic department of the AFL-CIO, and I should like permission, Mr. Chairman, to put this into the record because it bears on this point——

The CHAIRMAN. Without objection, it is so ordered.

(The bulletin referred to follows:)

[From Labor's Economic Review, December 1960]

IN BRIEF

Is it true—as business spokesmen allege—that America's failure to maintain a steady rise in new plant and equipment outlays is due primarily to a shortage of investment funds? Or is a lack of customers the major cause?

With business investment once again going down, Labor's Economic Review now discusses this timely and vital issue.

INVESTMENT AND ECONOMIC GROWTH

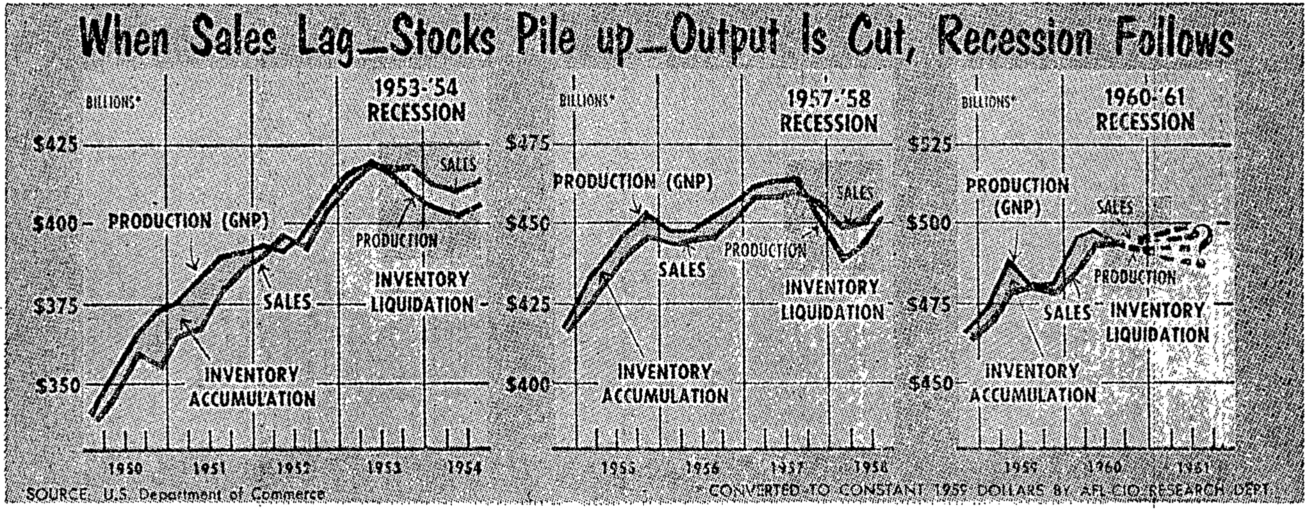
From 1951 through 1960, investment in new plant and equipment by all corporations and unincorporated businesses in the United States exceeded $300 billion. This record sum was spent (1) to replace worn out and obsolete facilities, and (2) to substantially expand our capacity to produce goods and services of all kinds.

Unfortunately, these capital expenditures—so important to America's economic growth—fluctuate widely from year to year. The gradual rise of the first half of the decade was interrupted by a falloff in 1954. Capital outlays soared in 1956 and reached an alltime peak of $37 billion in 1957. However, in 1958, they dropped to less than $31 billion. Then they started climbing again, but reached less than $36 billion in 1960, despite predictions of a recordbreaking year. And now investment is falling once more.

Why do plant and equipment outlays fluctuate so? What must be done to assure a steady capital expenditure rise?

It is evident—although some financial journals seem to deny it—that the major spur to investment is the expectation by businessmen that a greater output of goods and services can be profitably sold. When sales lag and existing facilities stand idle, on the other hand, this expectation naturally wanes. This, in fact, is the reason why outlays for new plant and equipment fell off sharply during the recessions of 1954 and 1958. And it is the reason why today, with about 25 percent of our total manufacturing capacity unused, investment outlays are heading down once again.

During the upward swing of the business cycle when sales are going up, capital investment goes up, too. However, experience has shown that even during recent periods of recovery from recessions, demand soon began to lag behind the economy's expanding capacity to produce. Sales failed to measure up to expectations and inventories started accumulating. Ultimately, production was cut back and another recession set in, as the chart below shows. And even earlier, soon after sales failed to show a steady rise, many businessmen started revising investment plans downward.


When Sales Lag—Stocks Pile up—Output Is Cut, Recession Follows
BILLIONS*
1953-'54 RECESSION
$425
$400
$375
$350
SALES
PRODUCTION (GNP)
PRODUCTION
SALES
INVENTORY LIQUIDATION
INVENTORY ACCUMULATION
1950
1951
1952
1953
1954
BILLIONS*
1957-'58 RECESSION
$475
$450
$425
$400
PRODUCTION (GNP)
SALES
SALES
PRODUCTION
INVENTORY LIQUIDATION
INVENTORY ACCUMULATION
1955
1956
1957
1958
BILLIONS*
1960-'61 RECESSION
$525
$500
$475
$450
PRODUCTION (GNP)
SALES
PRODUCTION
SALES
INVENTORY LIQUIDATION
INVENTORY ACCUMULATION
1959
1960
1961
SOURCE: U.S. Department of Commerce
* CONVERTED TO CONSTANT 1959 DOLLARS BY AFL-CIO RESEARCH DEPT.

As a matter of fact, even at the peak of our recent booms, when the production index was scoring new highs, the output of many plants still hadn't reached their maximum potential. Although manufacturers consider a 94-percent operating rate to be preferred, 14 percent of our total manufacturing capacity was standing idle at the close of prosperous 1956, according to the McGraw-Hill Survey. At the close of 1959, when another new output record was in the making, 15 percent remained unused. (See adjoining chart.) In short, the gap between demand, on the one hand, and what could be produced at maximum capacity, on the other, seldom has been completely closed except under the stress of national emergencies.

Would the country be better off, then, if businessmen were to adjust their investment plans to a lower but more stable rate in order to accommodate a lower level of demand?

Quite the contrary. In the face of the unlimited needs of our expanding population, the necessity to provide jobs for our growing labor force, and our inviolate commitment to help maintain the security of the free world, America must raise her economic sights, not lower them. Compared with the rate of economic growth of the Soviet bloc and of most of our Western allies as well, we already are falling behind.

LAGGING DEMAND—LAGGING INVESTMENT

What, then, must be done?

Since outlays for new plant and equipment are so closely tied to business expectations regarding future sales, major attention must be focused on ways to constantly expand our sales at home. These normally account for 95 percent of all of the goods and services America produces and sells.

What is more, about 70 percent of this domestic demand comes directly from the purchases, including housing, of 180 million American consumers.[1]

The demand from government absorbs about 20 percent. Business investment, which in turn depends primarily on the hope of rising sales to consumers and to government, accounts for the rest.

Notwithstanding, many business writers try to create the impression that the purchases of 56 million American families and of government have little or nothing to do with the capital investment process.

The Journal of Commerce, for example, viewing lower capital outlays with concern, sees new "incentives for job-making investments" as the answer. Yet, neither the spur of greater demand from consumers nor from government is, apparently, the incentive it has in mind.[2]

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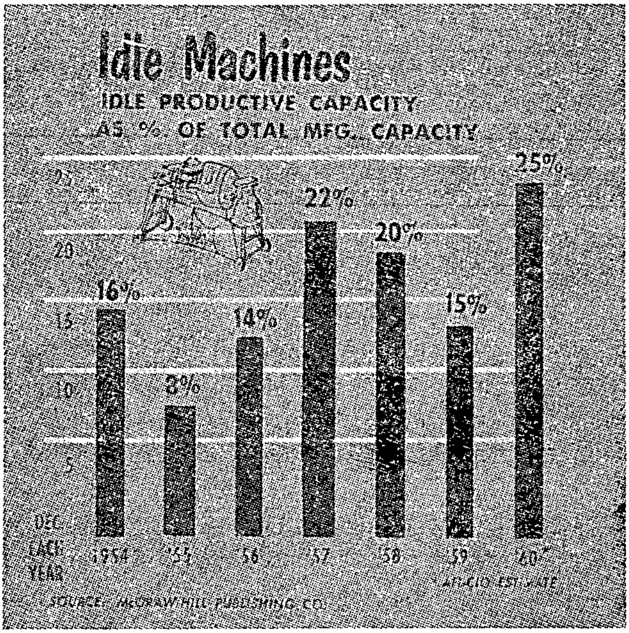
[1] See "Wage Policy for an Expanding Economy," Labor's Economic Review, November 1960.

[2] Dec. 20, 1960.



What, then, do these business spokesmen insist is needed to achieve a sustained investment rise?

According to the Monthly Letter of the First National City Bank of New York, the problem is essentially one of "lagging profits and lagging growth;" yet, the obvious fact that when growth ends profits inevitably fall, is conveniently ignored. Another problem "directly related to economic progress is a pinch on funds to pay for new machinery and equipment," the Monthly Letter alleges.[3]

In much the same vein, the machinery and allied products industry suggests that the bigger the pileup of savings, the more likely it is that capital outlays will grow. "If we are right that the enlargement of business investment depends primarily on an increased flow of funds available for that purpose," it concludes, "there is evident need for tax reform to encourage saving and capital accumulation." [4]

In brief, higher profits and more saving—and whatever tax concessions are needed to get them—are assumed to automatically insure greater investment and economic growth. This, in fact, is the gospel that our business journals embrace everlastingly.

It is evident, of course, that capital accumulation cannot be achieved without savings, and that capital will not be invested without the expectation of reasonable profit. Thus, the question needs to be asked and to be answered:

Are savings actually insufficient to meet the requirements of increased capital formation, and are profits, indeed, too low to provide a reasonable incentive for investment, assuming an expectation of a growing volume of sales?

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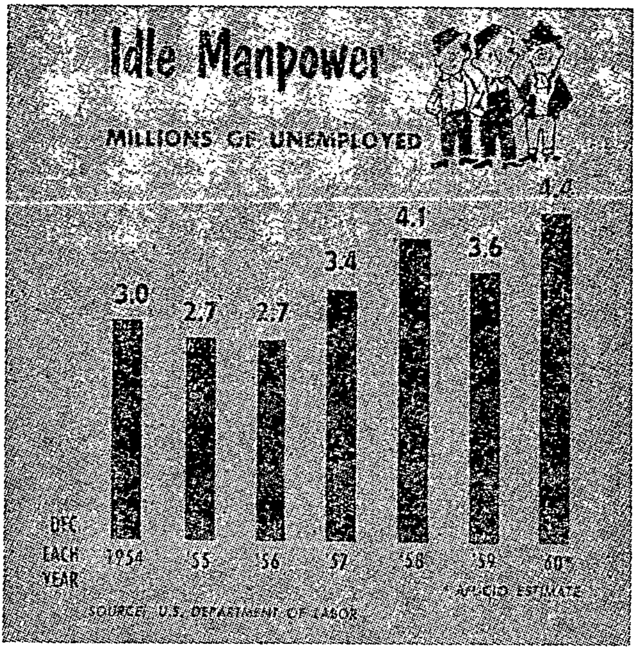
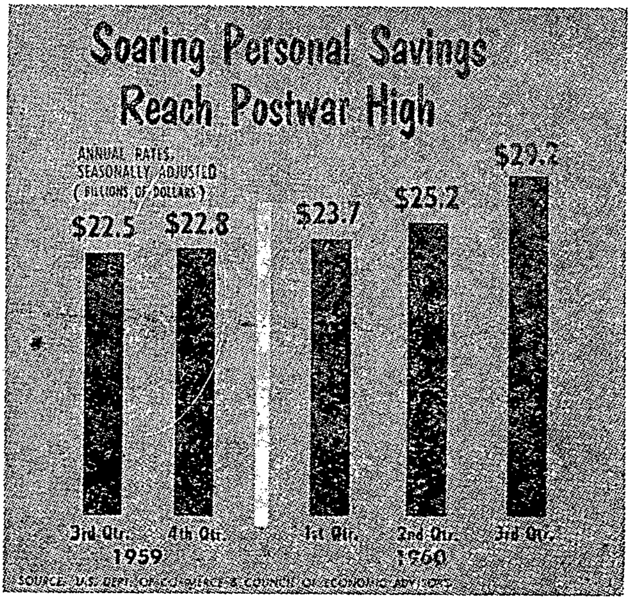
[3] December Letter, 1960.
[4] Capital Goods Review, October 1960.


Idle Manpower
MILLIONS OF UNEMPLOYED
3.0
2.7
2.7
3.4
4.1
3.6
4.4
DEC.
EACH
YEAR
1954
'55
'56
'57
'58
'59
'60*
SOURCE: U.S. DEPARTMENT OF LABOR


Soaring Personal Savings
Reach Postwar High
ANNUAL RATES,
SEASONALLY ADJUSTED
(BILLIONS OF DOLLARS)
$22.5
$22.8
$23.7
$25.2
$29.2
3rd Qtr.
4th Qtr.
1959
1st Qtr.
2nd Qtr.
3rd Qtr.
1960

NO SAVING LAG

The fact of the matter is that personal saving by individuals is today at a record postwar high, and funds, available for loan and investment are mounting in our savings institutions.

"Mutual savings banks expect a 16.7 percent rise in deposits in 1960," the New York Times reports.[5]

"The Nation's commercial banks, burdened with more idle funds than they have had in 6 years, are stepping up efforts to put them to work," the Wall Street Journal says. What is more, a growing number of the Nation's 6,230 savings and loan associations, "are in a spot most people would envy—they are finding themselves with more money than they know what to do with."[6]

But this isn't all. Insurance and investment companies and pension funds—through which billions of dollars of personal savings are collected each year—continue their vast accumulation. These too are available for lending and investing.

Taken as a whole, the personal saving of Americans had increased to the record yearly rate of nearly $30 billion during the 3d quarter of 1960. This is equivalent to 8.2 percent of disposable (after tax) personal income.

The growth of funds in savings institutions is a development that normally can be expected in the early stages of a business downturn.

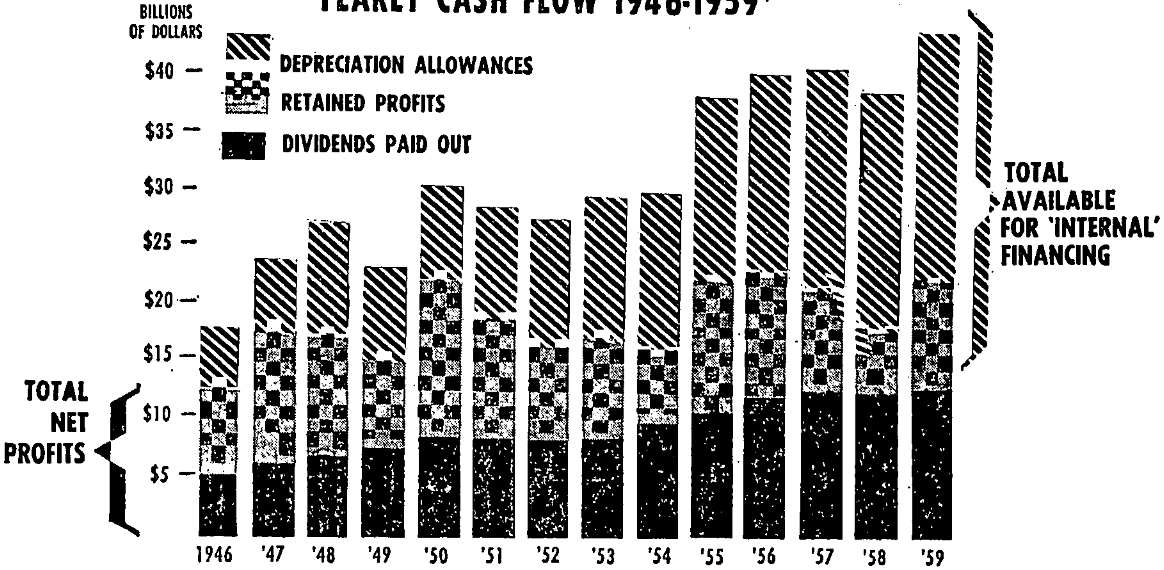
In the first place, as the economic pace slackened in mid-1960, the Federal Reserve System began taking steps to increase the lendable funds of the banks. At the same time, many families began to reduce their debts. Furthermore, as businessmen began to cut inventories, their cash accounts in the banks began to grow. Meanwhile, millions of people continued customary "contractual" saving through insurance and pension fund payments. In addition, the fortunate few who regularly receive more income than they can spend, continued to stash it away.

While the funds of savings institutions, as a consequence, have been rising rapidly, money demand for mortgages, for business investment, and for other purposes has been falling off. It is for all these reasons that these institutions now "find themselves with more money than they know what to do with."

[5] Dec. 26, 1960.
[6] Wall Street Journal, Dec. 6 and 7, 1960.

How "Internal" Funds Available For Corporate Expansion Have Grown

YEARLY CASH FLOW 1946-1959*



SOURCE: U.S. DEPT. OF COMMERCE

* EXCLUDES BANKS, INSURANCE COMPANIES AND SAVING & LOAN ASSN. DIVIDENDS FOR 1958 AND 1959, AFL-CIO ESTIMATE

THE NEW ERA OF "INTERNAL" FINANCING

While funds for borrowing and investing have been piling up in savings institutions, American corporations continue to store up a mounting supply of investable savings of their own. In fact, the problem for many is "what to do with the cash," Business Week says.

Over the postwar years, our larger corporations—the ones that account for most of the new plant and equipment outlay—have become increasingly free of dependence on new risk capital to finance their rising investment expenditures. Most of the outlay—and in many cases all of it—is now internally financed.

In an earlier day it was generally held that a substantial part of the money for business expansion should be raised by drawing in new risktakers through the sale of new stock issues to the public. By this process, not only would new capital be raised; the opportunities inherent in the free enterprise system would constantly be more widely shared.

During the postwar years, however, the record investment boom in new plants and machinery has been financed with scarcely any new risk capital at all.

From 1946 through 1959, according to the Department of Commerce, corporations alone, excluding banks, insurance companies, and savings and loan associations, invested $313 billion in new plant and equipment. But they raised only $34 billion by new stock issues during the entire course of these 14 years.[7]

Where, then, was the money coming from?

Almost all of it came from the internal flow of cash which builds up every year in company coffers. First, there are the undistributed profits which remain after dividends are paid. Then, there are the depreciation allowances which legally can be set aside each year as an offset against the cost of replacing worn-out and obsolete plant and equipment. Bank and insurance company loans and the public sale of stocks and bonds provided an additional, but minor source of funds for new investment. Of course, some of this vast money inflow was also used to finance larger inventories and to add to working capital.

Between 1946 and 1959, however, the cash flow from undistributed profits and depreciation charges alone totaled $298 billion. This vast sum was actually equal to 95 percent of the total outlay of all nonfinancial corporations for new plant and equipment during all these postwar years.

What is more, these internally generated investment funds have shown a constant upward trend since 1952, except during 1958, a recession year. (See charts, pp. 80 and 82.)

In 1958, the cash flow to corporations practically matched their entire investment outlay. In 1959, it exceeded total capital expenditures by $3 billion. And, in 1960—despite new plant and equipment expenditures second only to 1957—internally generated funds probably again topped capital outlays by about $3 billion.

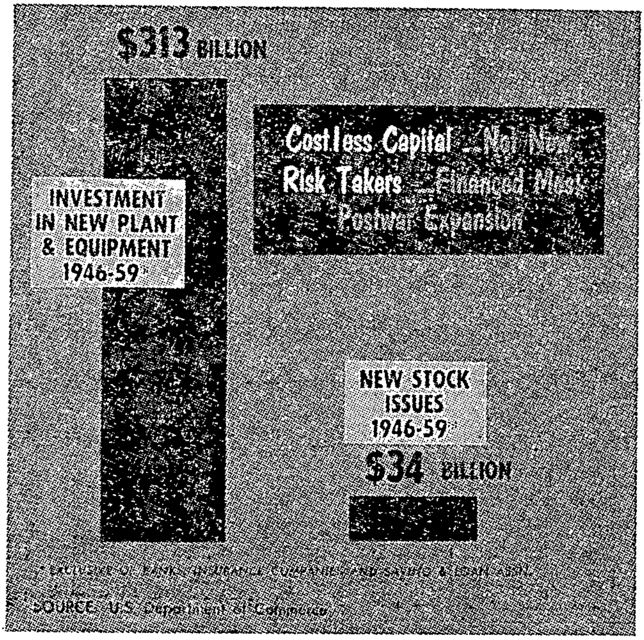
[7] Actually, over $8 billion of the $34 billion new stock total was issued by investment companies. Its sale did not represent a net addition to corporate equity funds.

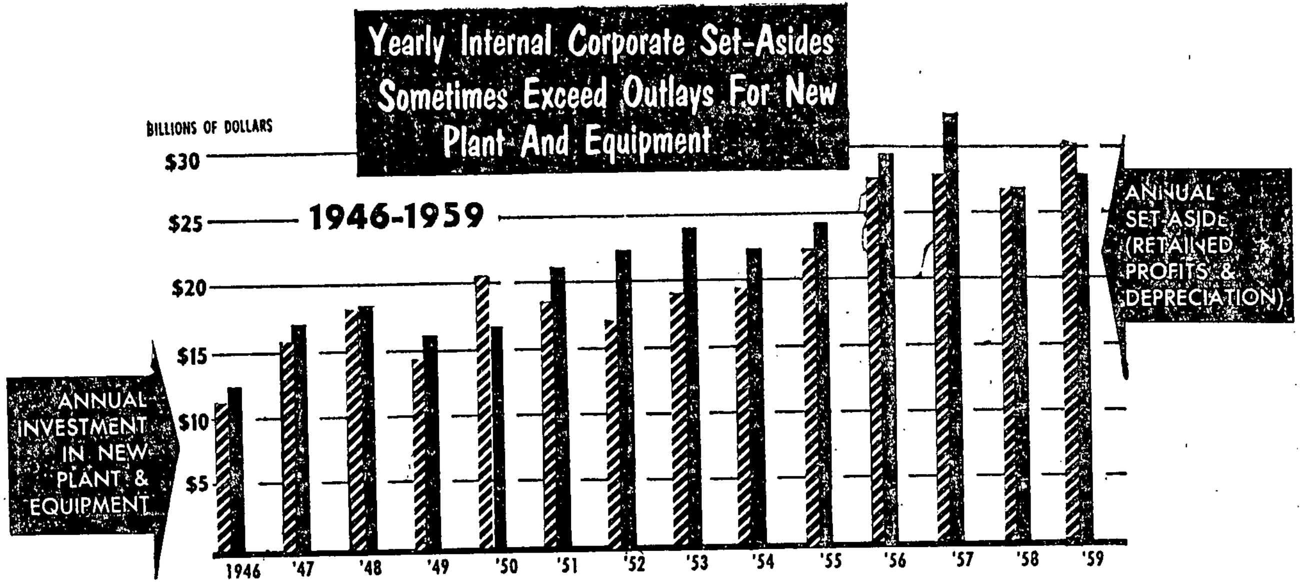
These rising caches of corporation savings help explain why the cash and Government security holdings of nonfinancial corporations exceeded $60 billion in 1959.

THE NEW BONANZA: "COSTLESS CAPITAL"

Internal financing has done far more than free many companies—and particularly the largest and most profitable ones—from dependence on additional risk-takers over the postwar years. The increasing use of costless capital—expansion funds on which neither obligations to new investors nor new interest charges are incurred—has gradually added billions to the real value of American corporations and, thereby, has tremendously enriched the owners.

From the end of 1951 through the third quarter of 1960, for example, stockholders' equity in manufacturing companies alone—the total value of property and cash reserves after all liabilities are subtracted—increased by $66 billion. This was a two-thirds rise in less than 9 years, according to the Securities and Exchange Commission. Yet, the actual net new risk capital secured by new stock issues totaled less than $4 billion.





SOURCE: U.S. DEPT. OF COMMERCE Excludes Banks, Insurance Companies, and Savings & Loans Assn.

Thus, there are indeed, good reasons why the price of corporate stocks has risen so rapidly over recent years. A large part of the increase simply reflects the real value added to existing shares because of vast capital expansion outlays based on internal financing.

All corporations, of course, have not been sharing equally in this bonanza. The opportunity particularly—but not exclusively—has been enjoyed by the most powerful and profitable "blue chips." Many of these are included in Fortune magazine's list of the 500 industrial giants who produced more than half of America's total manufacturing and mining output in 1959 and took well over 70 percent of the total profit.[8] These companies accounted for the lion's share of the postwar investment in new plant and equipment as well, and they paid for almost all of it with costless capital derived from internally generated funds.

Giant General Motors, for example, spent $5 billion for new plant and equipment from 1947 to 1959. However, internal funds—$3.4 billion from retained earnings and $3 billion from depreciation set-asides—added up to $6.4 billion over the period. They actually exceeded G.M.'s total capital investment by $1.4 billion.

General Electric spent $1.3 billion for capital outlays in the 10 years 1950 through 1959; but retained earnings and depreciation charges came to $1.6 billion.

Even the little giants use internal financing to advantage. For example, Firestone shows a 10-year expenditure of $524 million for capital equipment from 1951 through 1960. This was more than balanced off by depreciation charges and retained earnings totaling $673 million for the same period.

While these and other blue chips were spending billions for expansion—a large part of it overseas—hardly any of the cost came from new investors.

That internal financing now meets the largest part of corporate expansion costs is readily conceded and stanchly defended by most of the business fraternity. After all, if stockholders choose to forego dividends to expand America's capacity to produce, this is significant sacrifice for the Nation's good, they say. What is more, "corporate saving is the simplest, cheapest, and the most natural way to build a business," the First National City Bank Monthly Letter declared. Besides, depreciation set-asides are hardly sufficient to replace worn and obsolete assets in the face of rising costs, the financial journals allege.

Let us examine these contentions.

CONSUMERS PAY MOST EXPANSION COSTS

In the first place, postwar corporate profits have been so high that stockholders have been able to have their cake (gigantic undistributed profits) and to eat it too (ever-rising dividend payments).

Over the last 10 years, for example, the net after-tax return on the rapidly rising equity of stockholders in manufacturing corporations has averaged 10½ percent. This is comparable to the swollen profit rate which characterized the 1920's. Companies with assets exceeding $100 million actually averaged 11.7 percent after taxes during the 1950's, the Securities and Exchange Commission reports.

For all corporations taken as a whole, dividend dispersals have risen almost every year. They have soared from $5.8 billion in 1946 (the same amount as in 1929) to a record yearly rate of $14 billion in the 3d quarter of 1960. In all, $145 billion has been paid out in dividends over the postwar years—not an insignificant cash return for the stockholders.

But at the same time, net profits of all corporations have been so high it has been possible to retain an additional $147 billion in undistributed earnings for new capital investment.

Has this withholding of half of the nearly $300 billion of postwar after-tax corporate profit been motivated solely to assure America's economic growth? The reason, generally, has been less noble.

It is important to note that nearly two-thirds of the value of all personally held stock belongs to only 6 percent of American families, the wealthy few.[9] Although 4 percent of their dividends haven't been taxed at all since the Revenue Act of 1954 was passed, the rest still remains subject to high tax rates. However, when stocks rise in value and are profitably sold, only the maximum 25 percent capital gains tax applies. This fact explains why it is so profitable

[8] July 1960.

[9] Study of the Michigan Survey Research Center, late 1959–early 1960.

for the wealthy to encourage corporations to hold back on dividends, use undistributed profits for expansion, and then watch their stock values rise some more.

It hardly can be truthfully said that corporation profits—by any reasonable yardstick—have been unrewarding, and that as a consequence, the incentive to invest is gone. As a matter of fact, even though the economy has been declining since mid-1960 and substantial productive capacity has been idle, 1960 profits will be down "perhaps no more than 5 percent," according to predictions of Standard and Poor's.[10] What is more, it still will be "the second most prosperous year on record."

How have such high postwar profit levels been maintained—often, even at low operating rates—in the face of high taxes and other costs, and lamentation over the so-called profits squeeze?

The answer is that the American price structure, established and maintained in many industries by giant corporations, is set at such a high level it covers taxes and other costs and provides massive dividends and undistributed profits too.

In its December Letter, the First National City Bank acknowledged that "sometimes the idea is expressed that corporations should finance themselves to a greater extent by sales of additional stocks (and bonds)." But, it didn't bother to state the reason why this historic idea is still expressed. If the notion that new risk takers should play an important role in capital financing is obsolete, then let's face the implications.

From the business viewpoint, the use of internal financing to meet corporate expansion costs is, perhaps, the simplest, cheapest, and most natural way.

But by this device, the American consumer is actually forced to provide the costless capital to finance investment, through the high prices imposed on him. Thus—everybody pays for the tools to expand production, but only a handful get to own them and make profits from them.

ARE DEPRECIATION ALLOWANCES TOO LOW?

The financial journals do more than argue that top level personal income tax rates must be cut and that business profits must go up still more,—all in the name of building up savings and thus stimulating investment. They also insist that the depreciation allowances that corporations set aside each year—now the major component of the internal cash flow—must be substantially raised as well.

The crux of their argument is that high capital replacement costs make depreciation set-asides inadequate and that faster obsolescence requires faster amortization too.

Business spokesmen do not point out, however, that:

Depreciation allowances are seldom used to replace an old facility with a new one that is exactly the same. Generally, a far more efficient unit is installed which substantially increases output and at lower unit costs. This constant increase in the productivity of new capital largely offsets any increase in its cost.

Moreover, during World War II, the Korean war and again briefly in late 1955 and early 1956, the Federal Government allowed billions of dollars worth of 5-year fast tax writeoffs as an incentive to induce investment in defense supporting enterprises. The major beneficiaries have been heavy-goods manufacturers, utilities, and railroads. It is worth noting that most of these companies now own billions of dollars worth of highly profitable property which is still in use and is entirely written off.

What is more, in 1954 Congress changed the tax law to allow a more rapid amortization for business generally and it also sanctioned the writeoff of research and development expenditures as a current cost of doing business, for the first time.[11] These tax law changes have tremendously increased the annual cash flow of corporations and, because of them, the yearly net profit reports of corporations are now about $3 billion lower than they otherwise would have been.

For many companies depreciation set-asides alone are now greater than their entire current investment outlay. What is more, they are amounting each year.

According to Business Week, many companies are facing a dilemma about "what to do with the cash." Moreover, "In the next 4 years, rising depreciation allowances are going to throw off a record amount of cash into company treasuries. Traditionally, many companies earmark most—if not all—of this

[10] The Outlook, Nov. 28, 1960.

[11] See Federal Taxes * * * A Handbook on Problems and Solutions, AFL–CIO Department of Research publication.

cash for new plant and equipment. But it's possible that with depreciation allowances rising a good deal faster than industry's present capital spending plans, management will have to figure out what to do with the extra cash." [12]

Actually, this mid-1959 forecast underestimates the depreciation allowance pileup; it was written before new plant and equipment outlays started turning down.

FIRST THINGS—FIRST

Tax cuts now for corporations and the wealthy and larger depreciation allowances, are not the way to initiate a sustainable upward rate of investment and economic growth.

In the first place, there is no present shortage of savings for capital expansion, as we have already seen.

What is more, an investment boom can't be launched in an economic vacuum, no matter how high savings may be. First, sales must rise to stimulate the use of the greater part of the 25 percent of our industrial capacity now standing idle. Then, there must be a reasonable prospect that demand will continue to rise still further before a significant increase in productive capacity can be stimulated and sustained. (It should be noted that the capital investment boom of 1956–57 collapsed precisely because it was not supported by a continuous rise in sales.)

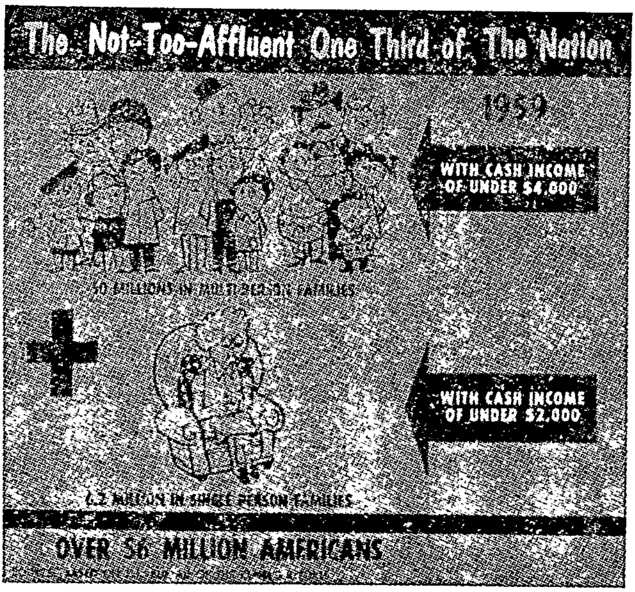
First things must come first.

What the American economy needs now—and what business needs—is more customers. And in seeking them we must bear in mind that the combined purchases of consumers and Government normally buy about 90 percent of all we produce and sell.

Although some tax assistance for small business should have a top priority unneeded tax stimulants for wealthy individuals and corporations can't be justified at all. Furthermore, they would undermine the demand for goods and services at a time when it must grow. The revenue loss from such tax reductions would either have to be made up by new levies on consumer income—and family spending would fall—or the Federal Government would be confronted by great pressure to cut down its own spending plans.

What is most urgently needed now, in the face of the recession, is a temporary cut in tax withholding in order to build up consumer sales. Over the longer run, Federal tax reform should reduce the unfair burden of lower and middle-income families. The revenue loss can be more than recovered by closing loopholes that the wealthy and many businesses now so illogically enjoy.

[12] May 16, 1959.



In our ever more complex economy, each part interacts upon—and must wholesomely support—the others; none can stand alone. Investment growth does, indeed, require enough saving to meet the needs of capital formation. However, if the economy is failing to generate the expanding demand upon which a sustained rise in capital outlays depends, no amount of saving—by itself—can insure investment growth. Thus, there must be a balance between saving and demand.

Unfortunately, the postwar costless capital boom and the price hikes that have sustained it has accounted in large measure for the failure of consumer demand to adequately grow.

With business now down again for the fourth time since World War II, and with each successive prosperity period getting shorter, who can deny that grave dislocations have been developing within the American economy? The demand of consumers and Government, in combination, just hasn't been large enough to fully utilize our expanding capacity to produce.

Despite postwar progress, the basic needs of millions of families still remain unmet.[13] Furthermore, the unsatisfied public service needs of all of us keep growing.

The time has come to rigorously examine the impact of all public and private actions that affect the economy and may be retarding the full use of our physical and human resources to meet the Nation's needs. The gap between demand and our productive capacity must be closed.

And, only by keeping it closed can a steady rise in plant and equipment investment be assured.

Mr. REUTHER. From 1946 to 1959 American industry invested in new plants and expansion $313 billion.

Senator BUSH. What is the period again?

Mr. REUTHER. 1946 to 1959.

Eighty-nine percent of that total capital expenditure was financed out of depreciation and the reinvestment of profits and only 11 percent, or $34 billion, represented new stock and new money that was attracted into the investment process. In 1959 American corporations received in depreciation writeoffs and retained profits a sum of money greater than their total investment.

The CHAIRMAN. I beg your pardon, what was that again?

Mr. REUTHER. In 1959 American industry accumulated in depreciation allowance and retained profits—this is all industry—a sum greater than their total investment.

Representative KILBURN. You mean to say they wrote it all off in 1 year?

Mr. REUTHER. No; I say that in 1959, if you take together their depreciation allowance and the profits they set aside for expansion, and most corporations do this, those two things together were greater than the total investment.

Senator BUSH. How do you measure that term investment? Does that mean in effect the total assets of all these companies?

Mr. REUTHER. New plant and equipment. This would also include modernization, automation of an old plant. It is their total capital expenditure.

Senator BUSH. For new plant?

Mr. REUTHER. It could be modernizing an old plant, too.

Senator BUSH. I misunderstood you. You said total capital investment. I presumed that that meant the total capital investment in all these companies, which did not seem reasonable.

Mr. REUTHER. Mr. Weinberg can give you the exact source.

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[13] See "America's Haves and Have Nots," Labor's Economic Review, August 1960.

Mr. WEINBERG. This is total plant and equipment investment of U.S. corporations. You will find the figures on page 196 of President Eisenhower's Economic Report. There you will see that plant and equipment outlays in 1959 amounted to $27.7 billion. Internal sources which include retained profits and depletion allowance and depreciation and amortization allowances added up to $30.6 billion, which was nearly $3 billion more than the total plant and equipment expenditures.

Mr. REUTHER. The point we are trying to make is that where you have this tremendous gap between productive capacity and actual utilization on the one hand and where you have accumulated profits and depreciation allowance together equalling the total investment, then to give tax incentive for plant expansion is just not very realistic.

Representative WIDNALL. Isn't the increase in production capacity of the steel industry due to the depreciation incentives that were given the steel industry to provide more capacity? If you relate production of today to the 1955 capacity of production, it would be pretty much up to 100 percent of capacity, wouldn't it?

Mr. REUTHER. I do not think the steel industry expanded since 1955 in the amount represented by their unused capacity. Some of that capacity came at an earlier date. The war period is where we stepped up steel production very fast.

Representative WIDNALL. It would certainly be fair in comparing the yearly production of steel to use the ton production year by year rather than the percent of capacity. There is far greater disparity when relating percentage to capacity than the actual production. It certainly is a far more alarming figure. When we are talking about tax incentives now to build more capacity, I don't think they are thinking of the steel industry, providing more production capacity for that industry. There are many other areas in the economy where tax incentives might provide growth in employment and might be very helpful.

Mr. REUTHER. Yes, but a tax incentive certainly would not be that selective. Take the General Motors Corp. This is by way of illustration of the problem. In 1958 the General Motors Corp. had a depreciation allowance of $420 million and they had an investment of $269 million. In 1959 they had a depreciation allowance of $413 million and an investment of $319 million. Ford Motor Co. in 1958 had depreciation allowance of $187 million, investment of $89 million. In 1959 Ford Motor Co. had a depreciation allowance of $173 million and investment of $175 million.

They don't really need tax concessions. They are only using 50 percent of their capacity now, anyway. What we need in the automobile industry, and what we need in the steel industry and in the electrical appliance industry are more customers, not more capacity.

Therefore, the tax relief should be at the level where it would reflect itself in the expansion of purchasing power. Again I say we are not against corporations having the kind of tax climate and tax considerations they need, but to give them relief when they don't need it, when that relief ought to be given to somebody else, is a thing we are concerned about.

The CHAIRMAN. Mr. Reuther, obviously we are not going to have time for the members to interrogate you. Would it be agreeable with you for either member who desires to do so to suggest questions to you and you will answer them for the record when you correct your transcript?

Mr. REUTHER. I should be most happy to cooperate.

The CHAIRMAN. Any member may ask any question in writing, or if any member desires he may ask questions without taking up too much time, to make sure that the questions are in the transcript.

Senator BUSH. Well, I don't want to shorten Mr. Reuther's remarks, which have been very interesting indeed, but I do have a couple of questions that I would like to ask him apropos of his own recommendations in here. I would hope we would not be foreclosed from that, Mr. Chairman. I have sat here patiently for an hour and a half with that expectation.

The CHAIRMAN. It is up to the committee. I want the members to ask all the questions they wish. Suppose you go ahead right now.

Senator BUSH. If you will permit me, Mr. Reuther, these are important questions. I will refer to your prepared statement first. The first question has to do with No. 13, "Reduction of the workweek, standard working hours under the Fair Labor Standards Act should be reduced gradually with no reduction in take-home pay as technological change accelerates and productivity rises."

Now, this morning we had a quotation from President Kennedy's address, to which you referred in complimentary terms, and I think it deserves commendation. He said, "We cannot afford unsound wage and price movements which push up costs, weaken our international competitive position, restrict job opportunities, and jeopardize the health of our domestic economy."

Now, I ask you to reconcile this recommendation of yours with that statement of his.

Mr. REUTHER. Very well. I think that anyone who has had any experience or contact with the basic mass production industry recognizes that the key to unit cost is volume. You have a certain fixed overhead—the cost of tools, the cost of plants, the cost of maintenance. The automotive industry, for example, is capable of turning out 10 million automobiles, which represents basically its capacity now; probably it is a little in excess of that. The unit cost comes down very sharply at that level of production as contrasted to, say, 5 million. Therefore, if we could get full employment so that we could get maximum utilization of our plant capacity and our manpower, we would thereby get the greater economies and the impact of those economies upon the unit cost of production. It is possible, and the whole history of America's technological development proves it is possible. After all, we have higher living standards today with an 8-hour day than we had when we worked 16 hours a day.

The answer is technological progress. We don't get the full benefit of technological progress if we limp along, using only half of our tools. The automobile industry is a good example. Consider the profits of the automobile companies. Take General Motors. In 1955, which was their best year, their profits were fantastic because their volume was high.

In 1945 and 1946 we had a strike at G.M. We said we did not want a wage increase, not 1 red cent that would mean a higher price. I still feel that way because that is robbing Peter to pay Paul. What we want is not higher wages or shorter hours out of the pockets of the American consumer. We want these things out of the fruits of our developing technology. But you can't measure what is possible if you are using only half the tools. You have to measure what is possible if you use all the tools and then find a way to use all the tools.

Now, on the reduction of the workweek. We came from 16 to 14 and 12 and 10 and 8 hours a day with the acceleration of technological progress. Now we have to figure out how to get from an 8-hour day to a shorter workweek so that people can have meaningful leisure. You can't make this decision arbitrarily in Government. You can't make it arbitrarily in labor or management. Therefore, there ought to be a long-range approach to this thing because workers are deeply troubled. When I sit at the bargaining table in 1961 the people I represent will be worried, as they have a right to be worried, that automation, instead of giving them more security, will give them greater insecurity, that the more productive they are the less secure they will be.

In other words, we are interested in full production but we also have to live and if we don't find some way to solve this problem within the framework of a full employment economy, we are all in trouble. We believe that if we can get the full impact of the greater efficiency that will come from the full utilization of our total technology, we can have higher living standards, a stable price level, and still do these things which we propose.

Senator BUSH. Thank you very much.

My second question relates to item 20 under international trade. I am familiar with the position of your organization over the years on this issue where you have generally stood for reducing trade barriers and promoting freer trade. I think you have done it very effectively. I, in a general way, lean toward that philosophy myself. As you probably recall, I was on the Randall Commission and you are familiar with the report which we made. But I feel, myself, that the situation has changed somewhat since then.

I would like to direct your attention to that item 20, especially where you say, "We cannot avoid the problem of unfair competition with some American products from low wage highly efficient foreign producers. To help solve this problem for all exporting countries which face it, the United States should propose through GATT and TILOT establishment of international labor standards provisions on wages and other labor conditions in export industries, directed at raising wages. I certainly agree with that too.

Let me ask you if you go further in your more recent thinking on this question. Do you believe that in connection with the unfair competition that you mention in here, and it is unfair when you consider the wage differential between, let us say, the Japanese worker and the worker in Detroit, Mich., or in Naugatuck Valley in my State which you are familiar with, do you think that to meet this situation in some of those aggravated cases we should adopt a quota system to meet it? Much has been said about that in the last 2 or 3 years. I notice that some of the component parts of the labor movement, I am not sure about your own UAW, but the CIO-AFL group—some of them are in my State—they have shown a tendency to turn around believing that they would rather build a little fence around the top of the precipice than build a hospital at the foot of the cliff so to speak.

Now, I have given you a rather long introduction but I wonder if you would care to comment on it.

Mr. REUTHER. I shall be very happy to, Senator Bush. You are right, there are many unions that are deeply disturbed about this problem of unfair foreign competition because their members are facing the hardship of extended unemployment. The textile industry, clothing industry, ladies' garment industry, electric industry, all are worried.

Senator BUSH. They have changed around, the clothing industry?

Mr. REUTHER. They are deeply disturbed. We have this kind of problem. There are no easy solutions to it. To begin with I think it would be tragic if America retired to a position of economic isolationism. I think there have to be strong economic ties among the nations of the free world. If we pull back, the Communists, Russia, will fill the vacuum. When a country becomes economically dependent it is subject to subversion and being taken over. So I think we have to have maximum interchange with the other countries in the free world.

The question arises, how do we go about doing that so that we minimize the disturbing effects in a country like the United States where we do have higher standards than most of the other countries? Now, historically, if we rely upon the old system of quotas and tariff walls——

Senator BUSH. I would differentiate between those, Mr. Reuther.

Mr. REUTHER. I agree there is a difference. What we need to do, I think, is to avoid the compounding of negative forces. You take the Japanese textile worker. I have been in Japan and I have studied the industry there, I know something about their technology, they have the same technology we have in the textile industry, exactly the same equipment, some of it made in Britain, some in Japan, some in Germany, but it is the same equipment we have.

So there they have a technology which yields the same productivity per 1 hour of work, but they don't have wages comparable to ours. This is a new, revolutionary factor in international trade. Historically, lower wages in other countries were related to less efficient tools and, therefore, lower labor productivity.

Now, if we said to the workers in this country that the answer to the threat of Japanese competition is to cut wages X percent, then the Japanese would just say that their workers were going to have to cut X percent to compete. Then you start an economic rat race that we can't win, because the Japanese worker can live on a bowl of rice and raw fish—I ate it when I was there—and we can't.

What we need to do is to find some new mechanisms. We have proposed one; we think it is one of the kind of things that ought to be thought through. If a company operates in one State, in your State of Connecticut for example, and if it sells its product only in Connecticut it does not have to be bothered with a Federal minimum wage, does it? The minute it sells in two States and has access to the American market, however, it is then controlled by the interstate commerce clause and it is bound by the minimum wage.

We say to the manufacturer in your State: If you want to have access to the American market, then you have to pay the minimum wage. This is what we consider to be the minimum of decency. This is what you have to pay to be in business. If you don't want to do that, then you have no right to the American market.

Why couldn't we say to the company in Japan or some other country, if you want access to an American market, if you are using the same basic tools, if an hour of human labor yields essentially the same productivity as the application of an hour of human labor in American industry yields, then you have the right to have access to our markets only if you will agree to a progressive narrowing of the wage differential.

If he won't narrow the differential by *x* percent this year, and *y* percent next year, he will pay a penalty in an equal amount in order to get access. So he will then have a choice of paying the penalty or a wage increase.

Now, when he grants a wage increase he does two things. He not only eases the pressure on us, which is good. He expands his own market. Take the German automobile industry. They are living in a fool's paradise. I told them this. If they think the German economy indefinitely can expand its automotive production and gear its future employment policies around the export of 75 percent of its total production to foreign markets, that is a dream world. Somebody ultimately is not going to be able to buy those cars.

Senator BUSH. I don't know whether you are familiar with the Keating bill, of which I was one of the cosponsors. Is this the general idea that Mr. Reuther is talking about there?

Mr. WEINBERG. The Keating bill does not exert the kind of pressure that we think an international solution through GATT, for example, would exert toward the upward movement of wages.

Senator BUSH. The recognized wage differential.

Mr. REUTHER. It deals with that aspect of the problem. We propose a mechanism which we think we can get through the GATT and their international approach which says "OK, we are not going to compartmentalize the free world, but if you want access to our markets, here is what you have to do, because your technology in this industry is comparable to ours, therefore, the wage differential has to be narrowed sufficiently so that it is manageable."

Senator BUSH. As a practical matter, do you think, and as I said, I am on that bill which is working in that direction, but do you really think that as a practical matter in view of our international relationships with Japan and other countries that would be effected by this that we could actually get away with that and would it not be a simpler matter and one which would have justice to them if we said, "All right, you have been going up, you had 5 percent, you had 8, now have 15 percent of our market" and it is perfectly clear that if they go on for another 5 years they will have 58 percent of that, if we said to them, "Look, this has gone far enough, we will give you 15 percent of the market and as the market grows you can grow with it."

Now, it seems to me that in the interest of the people that you represent, and I represent, that we have come to the stage in this thing where we have to consider something like that. And this would have much less impact on our international relationships than the plan which you just outlined.

Mr. REUTHER. This is a very complex problem.

Senator BUSH. It is not quite fair to bring it out here, but as long as you mentioned this in your own program I wanted to pose this question and perhaps we can discuss this at another time.

Mr. REUTHER. I think this is an area in which there ought to be a very concerted effort made to explore a number of new possible approaches. The old tools won't solve this problem, given this new revolutionary factor of a common technology that the world is going to have.

Senator BUSH. Is it asking too much if you would consider my proposition, my quota proposition with an open mind?

Mr. REUTHER. Well, the last time we were together you asked me to talk about the No. 9, and I have written you a letter which you will have on your desk today. I will be very happy to communicate with you on this other matter.

Senator BUSH. Thank you very much.

I have to excuse myself because we have on the floor a nomination which my committee is responsible for.

The CHAIRMAN. We have two other witnesses.

How much more time do you need?

Mr. REUTHER. You have been more than generous and I appreciate that I have taken a lot of your time. I do want to deal briefly with the flow of gold problem, since this is a matter of great importance to our country. I would like to quote again from Business Week of September 10, 1960, in which they say, "The main reason that companies are going abroad, after all, is because markets abroad are growing rapidly. If we are concerned about this competition for U.S. investment dollar the way to counter it is by stimulating faster growth at home. The migration of U.S. capital and the necessity of making the U.S. market more attractive to U.S. investors thus turns out to be an aspect of our most pressing general economic problem—achieving a faster rate of national economic growth."

That is to say, when industry has unused capacity here, why should they invest more money here to have more plants idle when they can go over there and participate in a market that is expanding. The way to keep that capital here and attract foreign capital, the only way you can equalize the balance of payment in terms of flow of gold, is to expand the domestic market so that there are attractive investment opportunities on the home front.

There are a number of other things that I would like to have touched upon, but I have taken a great deal of time. We would urge that you move in the field of education and in the field of the development of our resources because these are areas in which we think much remains to be done, and in which we can begin also to make a contribution not only to the problem that we are directly dealing with but to the overall economic situation.

I would like to say in conclusion, Mr. Chairman, that while I have painted here today a picture of grave economic distress, I have unlimited faith in our system of human freedom. I think we can do this job, but we cannot do it, we will not find the answer, excepting as we deal with this problem realistically and adequately. I would hope that your committee, after evaluating this situation, will urge the Congress to do what it can to implement the recommendations of President Kennedy which I think are fine, and to get into this broad, long-range problem of how we can have full employment and full production making the good things of life for people in peacetime.

Thank you for the opportunity.

The CHAIRMAN. I believe Mr. Widnall has asked some questions and also Senator Bush. These other gentlemen and Mrs. Griffith have not asked a question at all. Let us, for as brief a time as we can, permit these members to ask a question. Then we will yield to you.

Representative WIDNALL. I was going to ask: Are we going to have the opportunity to submit questions to Mr. Reuther and have his answers in the record?

Mr. REUTHER. I shall be happy to do it here or in writing.

The CHAIRMAN. Any member who desires to do so may submit questions to Mr. Reuther and he will answer them for the record when he corrects the transcript.

Representative WIDNALL. I appreciate your testimony. I just make one comment about that 19 percent reduction in auto sales. Anybody who bought an automobile in December or January in the eastern United States should have seen a psychiatrist first.

Mr. REUTHER. I can't argue with that.

Representative REUSS. Mr. Chairman, we are running 40 minutes behind. I think I will pass.

Senator PROXMIRE. I should like to ask one question.

This will just take a short time.

Mr. Reuther, in your statement you compare, as you compared in your remarks, the growth in 1953 to 1960 with growth in the preceding period of 1947 to 1953. I note that in 1953 to 1960 you say the growth was 2.4 percent, 1947 to 1953, 4.8 percent.

Now, this morning Mr. Clague appeared and he made a statement very similar to yours in estimating how much it would take to increase the gross national product in order to take up the unemployment we have in the economy. Dr. Clague said we need 4.4 percent just to maintain the present level of unemployment.

In other words, so that by December of this year you still have 6.6 percent of the work force out of work. I notice that you say on page 1 of your statement that in 1961 it will take 9 to 10 percent growth in order to wipe out the present unemployment and start in at a level of maximum utilization.

Now, my question is this: I listened to your excellent and persuasive testimony before our banking committee earlier. That was of the same nature as this. That is, that we are in a situation which is not temporary. It is long range, it is relatively permanent. I think it is very, very convincing. That is why I wonder about your recommendation about a temporary tax cut. It seems to me this could dig us into a very tough, deep fiscal hole. You recommend, as I understand it, a $10-per-taxpayer cut, which you have just told us would be $350 million a week. As I calculate it, it would be about a billion and a half dollars a month. If we did not increase our growth above 4 percent, conceivably we would have that for the entire year; we would be in a position, therefore, of having an increase in our deficit by some $15 to $18 billion—at least reducing our revenue by that much. I am wondering if this is a sound way to approach a situation which appears to have very permanent long-range symptoms.

Mr. REUTHER. Senator Proxmire, we are suggesting this standby authority and even this would be of a limited duration. Ten weeks would be the maximum that you could get. It would be $10 a week for 10 weeks. I think you have to look at this thing in the light of what happened in 1958. In 1958 we did not take aggressive actions. We sort of waited it out. The result is that we accrued a $12 billion deficit because the economy was in bad shape. This small reduction in revenue temporarily is like seed money. It is money that you plow into the economy in order to get a bigger crop down the road. While it would be temporary loss——

Senator PROXMIRE. You say a $3 billion drop in revenues if you do this?

Mr. REUTHER. It would be roughly three and a half billion dollars.

Senator PROXMIRE. I am wondering if this is psychologically the way to get money into the economy. You don't give it to people who are out of work as you do with unemployment compensation provisions. You don't give it to people who necessarily have to spend it. You are giving it to people who have jobs, who have income, and who psychologically, it seems to me, would be more inclined to save rather than spend this additional amount.

Mr. REUTHER. I think this primarily is a question of what the needs are. Now, I am for shoring up the unemployment compensation system—not only extending duration but making benefits more adequate. But if the impact of that and other things we will be doing is not sufficient to check and roll back this snowball which is gaining momentum, then you need something that has a broader impact. After all, only 6.6 percent of the workers are unemployed in terms of the total work force. If you had a $10 a week tax incentive in there and everybody was spending that, then you would get a much greater impact upon the economy. I think that by the end of the year you would have more than picked up the $3½ billion, that you would actually wind up with a smaller deficit with the tax cut than you would have if you did not have the tax cut.

Senator PROXMIRE. You say the 1958 deficit was not soon enough, the timing was wrong, that if the $12 billion deficit had come earlier it would have pulled us out of the recession quicker?

Mr. REUTHER. If we had had, in the early period of the 1958 recession, effective and adequate action at this level of the Government, I think the $12 billion deficit would not have materialized because we would not have gotten that far down the economic scale. If you move with maximum impact early, then you get greater response than if you piddle away, working on the fringe of the problem.

Senator PROXMIRE. Many economists like Dr. Heller agree with you. They always say that, but they never document it with any kind of evidence. They assert it and assert it very emphatically and persuasively, but they never support it.

Mr. REUTHER. I think you have an opportunity to build the record to show this will work by passing such legislation.

Representative GRIFFITHS. I would like to ask you in instances where American industry is selling cars to Brazil, on a 3-year extension of credit with the present inflationary spiral, would you say that it was proper for the taxpayer to guarantee the risk that the industry takes to make the sale?

Mr. REUTHER. Are you asking: Do I think that the taxpayer should be involved in that risk?

Representative GRIFFITHS. Would you say that it would be reasonable for the taxpayer to assume part or all of that risk in order to make the sale?

Mr. REUTHER. Well, really, I could not give you an answer quickly because I have not thought about it. I do believe that the American automotive industry has a real serious problem in terms of the world market. I think some of it is of its own making. I think these cars that are three blocks long and with enough chrome to cover the Pentagon Building are not the kind of product that people in countries with small narrow roads would buy.

The result is that when the European car industry began to offer an attractive product, customers turned to the European cars. I hope our industry will not only make a compact but that they will make a Volkswagen size, and then they will be able to compete in world markets. Then if we do that and if there are tax problems that ought to be explored, we would be quite willing to join industry and other people in jointly exploring that problem.

I have not thought about the specific problem you raised; therefore, I am not in a position to give you an answer.

Representative GRIFFITHS. Would you do that?

Mr. REUTHER. We shall check into it.

The CHAIRMAN. Thank you very much, Mr. Reuther. It was good of you to take as much time as you did. You may extend your remarks, just as we extend remarks in the House and Senate, and insert anything that is germane.

The next witness is Mr. Emerson P. Schmidt of the U.S. Chamber of Commerce.

Doctor Schmidt, we are delighted to have you, sir. You may proceed in your own way. You may insert your statement and comment on it, or you may proceed in any way you desire.

STATEMENT OF EMERSON P. SCHMIDT, DIRECTOR OF ECONOMIC RESEARCH, CHAMBER OF COMMERCE OF THE UNITED STATES

Dr. SCHMIDT. Thank you, Mr. Chairman. I would suggest that it be inserted in the record, if that is agreeable to you.

The CHAIRMAN. It may be inserted at this point. Then you can proceed and use excerpts from it or just comment anyway you desire.

(The statement referred to follows:)

TESTIMONY OF EMERSON P. SCHMIDT, DIRECTOR OF ECONOMIC RESEARCH, CHAMBER OF COMMERCE OF THE UNITED STATES

The opportunity to discuss the Economic Report of the President is appreciated.

The Economic Report is a quality document. Its analysis of the economic developments of 1960 and of the earlier period is forthright and helpful to any-student of government and others concerned. The statistical material, as in previous years, is comprehensive and well presented and amazingly up to date, even though later data will lead to some revisions.

Because of the rapidly shifting scene, both economic and political, these hearings would have been more productive a little later. The policy recommendations of the report and some of the judgments as to the current conditions and prospects of the economy are not universally shared. The report, in fact, is in a sense superseded by subsequent Presidential directives and messages, even though it was released only 3 weeks ago.

THE NEW ADMINISTRATION'S POLICIES IN BEING

The pronouncements and recommendations of the new administration differ substantially from those of the Eisenhower administration. The basic assumption of the report about the performance and the prospects of the economy are questioned by the new administration. A great number of task force reports have been turned over to the new President; some have been only announced but not released to the public. There is no way of knowing in advance in what way or degree these reports will become recommendations or policy. The President has issued innumerable directives, Executive orders, and made extensive recommendations to Congress. In his statement on the Program for Economic Recovery and Growth (February 2) he recommended more than a dozen major steps.

It takes time to assess both the meaning and impact of all these proposals, particularly with more to come. He mentioned many additional statements and proposals shortly to be forthcoming. Obviously, it is impossible to appraise in any useful way something which is still in the process of being born. Because of the key importance of our international balance of payments position, a report on it should have come before the one on February 2, which dealt primarily with antirecession and growth recommendations.

Since the normal purpose of your hearings is the evaluation of the President's analysis and recommendations, it would seem to make it inadequate to address your inquiry mainly to the Economic Report. It would be more relevant to stress the new administration's plans; but here we are, as of today, still partially in the dark.

The Economic Report fully recognized the pause and then decline in the economy beginning about midyear 1960. But the year as a whole reached new peaks in personal income, disposable income, and employment. Per capita disposable income, in constant prices, increased more than $40, hardly what we generally think of as a recession. Even in December employment was higher than a year earlier; in fact, the highest for any December on record.

GNP in real terms reached a new high.

Nevertheless, unemployment increased by 1.1 million, somewhat less than the rise in the labor force in this period, and corporate earnings, so important in stimulating new investment and innovations, are declining.

THE DISAPPOINTMENTS OF 1960

The year 1960 was something of a disappointment, but scarcely the failure which has been painted by some. The inadequacies can be explained readily.

1. The steel strike of 1959 explains much, perhaps most, of the decline after mid-1960. Business inventories moved from a decumulation in the third quarter of 1959—the strike quarter—to a rise of $11.4 billion in the first quarter of 1960, and then to a decumulation of $4 billion in the fourth quarter—at annual rates. Such a shift of over $15 billion in so short a period takes its toll.

2. The U.S. Treasury shifted from a deficit of over $13 billion in fiscal 1959 to a small surplus in 1960. This, too, represented a short-run deflationary force.

3. Meantime, the money supply failed to grow; during half the time in 1960 the money supply—currency and demand deposits—was below the yearend level in 1956, 4 years earlier. In December 1960 the money supply was $1 billion lower—preliminary data—than in December 1959.

4. The deficit in our international accounts ran close to $4 billion.

Thus, the combined effect of the inventory shift, the Treasury shift, the sluggishness in the growth of the money supply, and the international monetary and economic drain—these together may be quite enough to account for what happened in 1960. All of these matters, incidentally, relate to Government policies, a prime concern of this committee.

THE OUTLOOK

The Federal Reserve System moved toward credit ease quite early—April 1960. In recent months the money supply has been rising; if this rise was not merely seasonal, and continues, this might help to mitigate further decline in the economy. Inventory decumulation, which generally, in a mild recession, runs for a year or longer, probably has not yet run its full course. Some raw material, durables, and automobile inventories are still high.

Government expenditures at all levels will rise throughout the year. Except for new housing starts (current), the outlook for construction in general appears promising. Residential vacancies, while uneven, are high; the demand for new housing has abated. Because of unusually prolonged severe winter weather in the densely settled part of the country, perhaps the worst in 50 years coming in the wide geographical spread, housing starts are further depressed. But they should begin to rise next month, which might bring the total starts close to the 1960 level. Mortgage money has not become much cheaper or more readily available. The weather factor has slowed other businesses as well.

Plant and equipment expenditures are still pointing downward.

With two or three exceptions, the dozen key economic indicators of the prospects are sluggish or pointing down. The stock market does not at this time forecast any serious decline; otherwise there is little evidence in any statistical series now available (February 7) which points toward an imminent upturn. But this does not mean that a near-term upturn is not in the making. Once inventory decumulation in the aggregate ends, this alone can pave the way for stopping any decline and create the way for recovery. A consensus now regards the first quarter as a probable low of this recession, partly because the weather has had this adverse effect. But the ability of calling turning points is underdeveloped.

Because the situation is sensitive and could tilt either way, the steps of the new administration and the Congress will be quite decisive.

The bleak picture painted by the President of the "chronic production gap" and the "slow growth of the last 7 years," "falling farm income since the early 1950's," etc., in his statement to the Congress on January 29 and repeated in his February 2 release, can scarcely be expected to engender business confidence in the future, although mere talk rarely changes the behavior of the economy as a whole.

Such talk, however, a columnist said last Saturday, might cause people to take to the storm cellar, not buy that car, not start that new house, and if they have stocks, sell fast—your job might be the next to go. "It's alright to call a recession a recession * * * and a slump a slump. But it's also well for a President to note that his words might just carry weight; therefore he must weigh them." (The Washington Post, p. C7, Feb. 4, 1961.)

Since the campaign and the election are over, it might be more useful to analyze the nature of the causes of the difficulties, even though it's probable that we can't talk ourselves into or out of recession.

We've had a farm problem, for example, not just since "the early 1950's" but for 30 years—except for the war and early postwar years. Farmers received almost the same total income in 1960 as in 1950, and there were fewer of them in 1960. In the past 3 years, income per person on farms averaged higher than in the first half of the 1950's. The trend of net income from farming per farm has been upward since 1955 in constant prices. (Economic Report of the President, 1961, p. 201.)

Similarly, "business bankruptcies highest since the great depression" is quite misleading. In October 1960 (latest figure) the number of businesses operating was the highest on record: 4,725,000. The failure rate in 1960 was below the rates in 1938, 1939, and 1940, some years after "the great depression." The number of failures in 1960 was a little above 1939 and 1940, but in those years the number of businesses operating averaged only 3,271,000, while in 1960 there were about 4.7 million, a rise of about 47 percent.

But enough of this "numbers game." Even without artifice in picking base periods or particular data, anyone can convey almost any mood or mind-set which serves his purpose; false figures can do even more so, for the moment, until someone else makes a correction, but corrections have a hard time catching up, not to mention overtaking the errors.

Nor is the foregoing intended to minimize the difficult domestic and international problems facing the United States. The problems are real. Skilled and valid diagnosis is required, and the "medicine" administered should be such as "will take."

Unfortunately, in the President's Program for Economic Recovery and Growth (February 2), there is very little economic analysis; on the contrary, he recommends a large number of steps; but it is not possible for the reader to appraise the merits of these steps because of the gaps. He stated repeatedly in this document that he would fill in with additional directives, messages, etc., as he did on February 6 in putting forward his proposals for meeting the international balance-of-payments difficulties.

The message of February 2 states categorically, "The programs I am now proposing will not by themselves unbalance the budget which was earlier submitted * * *." This is true only if the steps suggested are effective in a substantial way or if automatic recovery takes place close to a full employment level. We neither know whether automatic recovery is on the way or will take place, nor do we know whether these steps proposed will on balance nudge the economy toward higher levels or not.

The section on agriculture states that falling farm income has been a drag on the industrial economy. Again this is not proven. Lower prices for food and fiber are to some extent a stimulus to the economy, even though, regrettably, low farm income means that our farmers and their families are not enjoying as good earnings as desired.

This section also states, "The farmer should receive for his managerial skills, his labor, and his capital investment returns that are similar to those received for comparable human talents and resources of other types of enterprises." As a long-range ideal this is both morally defensible and economically sound but it is not economically sound if we have an excess of human and other resources in agriculture, as most people and most students believe is the case. There is no merit in "keeping them down on the farm" if migration to better-paying jobs could improve them, and if the economy would be more productive and efficient as a whole through better allocation of resources.

Indeed, later in the statement the President points out that effort will be made to direct resources into those areas that are growing most rapidly and where demand is strongest. Actually, if unhindered, this is the way in which a free market economy operates. Both the worker and the investor always tend to seek the best opportunity in terms of remuneration; this improves the earning power of these workers and the investors. Furthermore, it enriches all of our people.

In the recommendation that long-term interest rates should decline while there should be a rise of short-term interest rates (in terms of international balance of payments considerations), one should raise the question whether this is either possible or a sound conclusion. If U.S. long-term interest rates are forced down—in other words, if the earnings of capital are going to decline—will this not augment shift of resources from the United States into foreign investments and thereby worsen our balance-of-payments position in the short run and the intermediate run. This is a most complicated question dealing with millions of decisionmakers, so one should not be dogmatic on this point, and we raise it only for the consideration of the committee.

It is quite conceivable that the February 2 report places undue emphasis on artificial efforts to manipulate interest rates. The President stated that he had directed the Federal Housing Administration to reduce the maximum permissible interest rate on FHA-insured loans from 5¾ to 5½ percent. Apart from the possibility that this may have been beyond his authority, it is significant to note that its purpose was promptly, and in fact immediately, offset by a further discount of 2 percentage points in the value of mortgages.

This should be another striking lesson to us that it is not possible for the President of the United States or for the Congress or for any central agency to dictate the interest rate, short of complete regimentation and extensive controls over saving, investment, and related matters. Whatever interest rates exist in a market which is workably competitive are the results of millions of decisions by savers, lenders, and borrowers.

With regard to the various Federal Government programs that the President said he would stimulate, it would have been helpful if the international balance-of-payments implications were spelled out. For example, it's quite conceivable that a considerable number of the domestic programs to be stimulated will increase our imports. Certainly efforts to promote construction are likely to be accompanied by rising imports of plywood. The same may be true of cement and some other components used in construction.

It was somewhat unfortunate that the President referred to the expansion in social security, including unemployment compensation, as being financed on a self-supporting basis. Social taxes are to be increased, but the unemployment compensation program will not be self-supporting for 6 years. But, equally important all Government activities (except those financed by deficit spending) are self-supporting and these social legislation programs are no different. Simply because these programs are outside of the conventional budget does not mean that they are outside of the total cash collected from American citizens and business; taxes tend to be deflationary, and it is not wise to try to leave any other impression or to talk about self-supporting Government programs which rely exclusively on taxation for their financing.

Furthermore, if the social security program is greatly expanded and new programs are adopted including the extension of unemployment insurance, it is of the highest importance that the same law providing for new programs and extensions should concurrently also provide for the financing. The only way in which a popular government can maintain fiscal responsibility and fiscal self-discipline is to tie expenditures and the revenue raising aspects into the same programs at the same time.

It is very doubtful that it is wise to convert unemployment insurance from its traditional purposes into a relief program as is suggested by the proposed aid to dependents of the unemployed. From a humanitarian approach this undoubtedly has a strong appeal. But it is of the utmost importance that we keep our programs as clean and clear cut as possible. If Government aid is justified it is better to develop a separate program and carry it out apart from the programs which have been developed for a rather specific purpose and have been, by and large, kept out of the relief connotation.

With respect to distressed areas it's very difficult to conceive of any substantial benefit from the proposed $100 million a year or so, since it takes $15,000 on the average to create one job. Thus it is clear that as the Secretary of Labor, Arthur Goldberg, pointed out in his address to the National Press Club, jobmaking must be primarily and fundamentally through the private sector of the economy, unless it can be demonstrated that the proposed depressed area legislation has a large multiplier effect—which has not been done. We should not talk of depressed areas. This provides a false signal in many cases. It may be a major industry that is depressed. In some cases it may be more humane to encourage outmigration. This is a case, furthermore, of raising false expectations of hope to the unfortunate people (workers, investors, and others) via this program. Even tremendous Government spending cannot lead to creation of job-producing plants in areas where it is uneconomic to locate them, or the jobmaking climate is not favorable. When the depressed area bill was introduced, a West Virginia newspaper ran an editorial "Help Is on the Way" (Spirit of Jefferson, Charles Town, W. Va.). This may paralyze local effort in many cases.

Nearly all American citizens have been concerned with our rate of economic growth, vis-a-vis the U.S.S.R., etc. Yet in 1961, when much concern about more growth is evident, the President recommends that the retirement age for males be reduced to 62 years. But if we are in as serious an international and domestic situation as has been suggested, it would seem that this is no time to adopt a policy which is largely irreversible, which will reduce our labor inputs in the long run. Furthermore, by permitting retirement at the age of 62, even though at a slightly reduced pension, the average pension per recipient will decline. This will simply provide additional arguments for more attempts to raise the benefit levels (because some ambiguous or meaningless average is low), whereas the original purpose and in the views of most experts the primary purpose of social security is to provide a basic layer of minimum protection to prevent destitution, with the hope that the self-reliant and energetic individual will build on that basic layer and thereby provide largely for his own security.

In speaking of natural resource improvements, the President talked about improving grazing resources. This is a rather odd suggestion at a very time when we are plagued with agricultural surpluses and struggling to take more land out of use.

It is somewhat surprising to find a great push for raising the minimum wage and extending coverage at a time when we have considerable unemployment, and even at existing wages young people and unskilled workers have an unemployment rate two or three times the national average.

Even though directly the higher minimum would not affect most of our export industries, the portion of that trade which it would affect might just be crucial.

Furthermore the analysis is quite deficient. A push at the minimum has upward pressures on wages above the minimum because wage differentials are highly prized by workers and they serve an important allocative function. What is more, the suppliers of our high-wage-paying export concerns, are bound to have some workers paid and worth only the present minimum, and they have suppliers of raw materials, components and subassemblies, etc., who may be substantially affected by the rise of 15 or 25 percent in the minimum wage.

While inflation has many contributing factors, this committee should note that the recent price rises started in March 1956, the time when the previous higher minimum went into effect, after nearly 4 years of substantial stability in the Consumer Price Index.

It seems humane to support a higher minimum; but this is not a guarantee that the worker can find an employer who is willing and able to pay the higher rate—along with the fringe costs, many of which are tied to the basic wage rate.

If we are concerned with unemployment, we should not make it harder for workers to get and hold jobs.

INTERNATIONAL BALANCE-OF-PAYMENTS POSITION

Earlier it was mentioned that the balance-of-payments message should have preceded the economic message. There is much good in the former (Feb. 6, 1961), particularly its emphasis on maintaining and improving our competitiveness in foreign trade—both at home and abroad. The importance of effective cost control is most urgent. Any tax changes and reforms should be designed to spark productivity and lower costs. Freer depreciation policy, at the discretion of business management, might help considerably.

Since labor costs represent some 70 to 80 percent of the components in final product prices, such costs should be examined most closely and Government through intervention in strikes and strike threats should be avoided (other than mediation) because experience shows that such intervention is almost uniformly on the side of cost raising—such as the New York tug-ferry strike settlement via Government intervention in January 1961, as shown in Economic Intelligence, February 1961, pages 1 and 2.

Nevertheless, the international balance-of-payments analysis message proposals leave much to be desired. At some points the analysis, conclusions and worsen our balance-of-payments position.

It states that the President has instructed the Bureau of the Budget, etc., to reassess oversea expenditures with a view to redducing our outpayments; this is good, but not enough. Congressman Barr last year suggested, wisely, that domestic expenditures and appropriations be examined similarly. This is important because many domestic outlays involve import components. For example, any artificial stimulus of new housing might greatly increase the importation of plywood, which would require our earning foreign exchange to meet the payments. This is but one example, possibly not a good one, but it illustrates the point.

It is also inevitable that as our economy gets rolling faster, our imports will rise; we need the recovery and growth, but we must recognize that this may worsen our balance-of-payments position.

The "basic deficit" referred to is difficult to understand. Our highly favorable export-import position in 1960 probably was exceptional; at least, there is no certainty that it will be repeated in 1961 and years ahead. Should we recover from the recession our imports will rise; should the foreign boom level off, this may reduce our exports. Much of the export boom in 1960 related to aircraft and cotton, although there were smaller improvements in most other major sectors.

The message includes in our balance sheet our long term and fully committed investments abroad; but surely these are not available to meet claims—they frequently are in brick, mortar, machinery, etc.

The message proposes a policy of raising short-term interest rates and lower longer term rates. While there is some question whether monetary, credit, and debt management policy can make this come off; there is another problem. Such lower rates might very well induce longer term domestic funds to seek foreign outlets and simultaneously reduce foreign savers' and investors' incentives to invest here—to move their funds to the United States, thus worsening our balance problem.

The section on the International Monetary Fund as a source of relief may give a false impression of availabilities. The $4.1 billion said to be available may be quite misleading. This is a complicated subject in which I don't profess any real competence at all and therefore I raise the point only with the hope that it might induce the committee to hold separate hearings on the President's message and the problem.

Actually, only 25 percent of the above figure, the so-called "gold tranche," is readily available for our drawing. Another 25 percent can be drawn with some specific effort and justification on our part. The remaining 50 percent is available, as I understand it however, only after exhaustive investigation by the fund, with the right of the fund to require, as a prerequisite to our drawing the funds, of the U.S. Government innumerable changes in our fiscal, monetary, spending, and other policies. The fund is not allowed to make the advances, out of hand; It must satisfy itself that we are doing what is necessary to correct basic or fundamental disequilibrium in our international balance of payments condition. Are the President, the Congress, and the country prepared to take orders on domestic questions from an international agency? Possibly I have stated this badly, but to the best of my knowledge, this is the situation we face.

Section I (1) seems to "buy" the idea of international liquidity deficiencies. Certainly many experts disagree on this.

Prof. Robert Triffin has argued the case for the deficiencies. He seems to favor converting the IMF into a world central bank, to which our own highest monetary authorities and the Congress would have to bow. In fact, Senator Douglas, the chairman of this committee, last December in the hearings on "Current Economic Situation and Short-Run Outlook," praised Professor Triffin in these words, "I guess we are all waiting with great expectation to hear the remarks of the next participant * * * the foremost authority in this country, possibly in the world, on gold and gold movements, Professor Triffin * * *" (p. 169).

This was indeed high commendation and certainly Professor Triffin merits a hearing. But many other authorities and money market experts do not agree with him. In fact Per Jacobsson, managing director of IMF, who has few if any peers in this field, disagrees fundamentally with Professor Triffin on this key issue. He said, "I must tell you frankly that personally I cannot see any value in Dr. Triffin's scheme as such; on the contrary, I believe that it can be positively harmful. I use these words deliberately, firstly because they do represent my considered opinion, and secondly because I think that attention may be diverted harmfully to an impractical scheme which, in any case, I am sure will never be adopted." (Ibid., p. 172) Dr. Jacobsson went on to deny any general international liquidity deficiencies. Many others have come to this same conclusion. We should find out who is right.

The President hints that we might let go of the 25 percent gold reserve requirements of Federal Reserve liabilities. Had he forthrightly, at this point, urged Congress to amend the Employment Act of 1946 to include among the goals the integrity of the dollar, this would have served notice to all of us and foreigners that we will not permit rampant inflation.

The message also urges higher interest payments on foreign balances left here. This may encourage subterfuges; it discriminates against our own savers. This is protectionism in reverse.

Again, let it be stressed there is much good in the International Balance of Payments message. The tone, by and large, is good. But the difficulties may be greater than is realized. Proposed remedies may not remedy and may even create new problems.

The Chamber of Commerce of the United States has repeatedly warned in many different ways and statements of the dangers of overloading our economy. As long ago as 1951 we published "How Much Can Our Economy Stand?", a carefully worked out analysis; while the report is now 10 years old, its basic theme is still relevant. Now we know we are in a serious international balance-of-payments constraint and domestically, high disincentive taxes and the cost-price squeeze are slowing down the economy and our growth.

It is the particular functions of your committee to provide us light and understanding on these critical domestic and international economic problems and I would personally hope that your forthcoming report would stress analysis, careful weighing of the pros and cons of every key economic issue growing out of the Economic Report of the President and the subsequent reports and proposals from the new administration. Such an approach might lead to a unanimous report of your committee and be of great help to the administration, Congress and the public and enhance the stature of the Joint Economic Committee itself.

Dr. SCHMIDT. We are getting a very late start and I suspect all of you are very busy people. I wonder whether it is worth your time for me to go through this memorandum.

I was glad to hear your opening remarks, Mr. Chairman, that you felt that the new administration's economic messages were at least as important or more important in a sense than the President's Economic Report, because in one sense the President's Report is superseded by the numerous new approaches.

So actually I have somewhat anticipated your own thought by addressing myself more to the new messages than I have to the President's Economic Report. I think it is a good one and it is very useful—excellent data in it. But even under the new administration we are still very much in the dark because a great many messages are still to come, and I am not sure just what parts the Congress is willing to accept and what parts of the proposals Mr. Kennedy will implement on his own initiative without legislation.

So in one sense these hearings are a little badly timed. It is no fault of yours, it is just the situation.

On the short-run outlook for the next half year or so I think that there is a growing consensus that the current quarter may be the bottom. This was accentuated, I think, by the extremely adverse weather factor that helped to pull the economy down.

I had thought a few weeks ago that the second quarter was more likely to be the bottom, than the first. This may be reversed; but actually nobody knows. I am a little disturbed at the somewhat alarming comments that we hear about the American economy. It is far from perfect. While it was something of a disappointment, 1960 really was our best year in history in terms of real income, gross national product, and even employment. The employment last December was actually higher than it was a year ago, in fact, the highest December in history.

I think we all ought to be concerned about unemployment, but we should not really bandy about this new figure of 6.8 percent. What you really ought to be concerned with is the number of people that are unemployed above some frictional minimum. What that figure is I don't know. I made a study some years ago and I discovered that whenever unemployment dropped below 5 percent there tends to be pressure on the Consumer Price Index. This is unfortunate, but I think it is something of a fact of life. So maybe 95 percent employment with 5 percent unemployment, or maybe 96 percent employment with 4 percent unemployment, is a sort of norm to expect. Then the problem is that proportion of the unemployed above that percentage figure. I think you can get overly worried if you don't look at the data in this way.

By this I don't mean to minimize the significance of unemployment. If even 1 man, particularly a man with family responsibility, is unemployed, in one sense this is as big a tragedy as if 1 million men are unemployed, because there is really no more suffering, individual suffering and personal suffering, if 1 million men are unemployed than if 1 man is unemployed. We ought to think of it in terms of individual human beings and not think in mass terms.

Why was 1960 something of a disappointment? I think the steel strike is perhaps the major explanation. We had decumulation of inventories during the steel strike in the third quarter of 1959, and then we had a tremendous buildup and inventory accumulations were running at $11.4 billion in the first quarter of last year, and by the fourth quarter of last year inventories were being decumulated at the rate of $4 billion. All of these are annual rates.

You can't subject our economy, without adverse impact, to this kind of a tremendous pressure of building up at that scale, and then running down again, which is a $15 billion impact or wallop on the economy.

The second factor which explains the somewhat disappointing performance of the economy last year is the rapid shift from a huge Treasury deficit of $13 billion in 1959 to a balance or even a little surplus. Prior to this recent period, the Government was paying out more money than it was taking away from you and me and business and so on. Then it shifted and actually accumulated a little surplus. This happened to coincide with the other contracting forces.

The third factor is the sluggishness in the growth in the money supply. In the last several years that has been so. As a matter of fact, if you look at the data you will find that the money supply in most of last year was no higher than the year-end money supply of 1956. This isn't quite a fair appraisal, because there is always a pre-Christmas seasonal rise in the money supply, but nevertheless, it is symptomatic of something that went a little wrong in the economy.

The fourth factor is, of course, our international balance of payments deficit. In other words, we couldn't consume that deficit, and that deficit was consumed elsewhere.

I think these four factors together adequately explain to us what happened in 1960.

I don't look upon this situation as being one where we have to be terrifically alarmed. It is regrettable, but it does not call for bold strokes of manipulation and of surgery in the economy. The corrective forces plus the built-in snubbers and the contracyclical monetary policy are likely to be adequate to bring us out of the recession.

Now, whether we will get the growth we want, in the light of the growth of the labor force, which will be 50 percent higher in the 1960's than it was in the 1950's, I am not sure. This depends primarily on profit expectations, not necessarily profits, but profit expectations.

If there are profit expectations, if they are high enough, we will have no trouble putting this growing labor force to work. This is why I would part company with some tax reformers. I think the greatest leverage you can get in our kind of economy is via the saving route, and via the investment route. This notion that we have excess capacity, 25 percent excess, this is simply foolish. There is no statistical evidence for that figure.

Furthermore, where would you get the manpower to utilize this extra one-third? If you add 25 percent on to our present rate of operations, where would you get the manpower to put this additional so-called excess capacity into action? It doesn't exist.

So we do not have 25 percent excess capacity; we may in certain industries, or certain companies, but not for the economy as a whole. As a matter of fact, even as to West Virginia, I was just reading a report from the government of West Virginia (the Employment and Industrial Review, January 1961), and they tell us that in even the depressed areas, there are shortages of the kind of labor that they need, the technically trained, and not simply engineering, but some specialized skills that are actually short. I was a little surprised at this forthright statement about the indirect effects of the decline of the coal mining industry in this official document. It says that the indirect effects or the loss to the State was due to the failure of new industries to locate in West Virginia, because of the adverse economic climate in West Virginia. In addition, the report mentioned the refusal of established businesses to expand "because of uncertainties" in the State of West Virginia.

We need to get at the causes of these troubles.

I don't think that there is any evidence among competent objective scholars, that recessions are due to the deficiency of purchasing power.

Senator PROXMIRE. What is that? I didn't get that.

Mr. SCHMIDT. I don't know of any competent business cycle experts, like those at the National Bureau of Economic Research, who are thoroughly objective and we think of them as the high priests in economic research, who regard deficiencies of purchasing power as a cause of recessions and depressions.

Actually, the economy goes into a recession when purchasing power is at an alltime high, and then after it has gone down a while and the purchasing power is low, recovery begins.

Purchasing power, of course, is important. There is no need having productive power if you don't have consumption, and the end of economic activity is consumption. But there needs to be a balance. Increasing the purchasing power, such as a general consumer tax cut, might give you a momentary upward thrust like the soldiers bonus did in 1936, but it will not get you off dead center in the long run, so far as I can see.

The bleak picture that is painted—and I have a number of references to it and I will skip them because of the problem of time—are likewise important. I will make just a few summary remarks.

The President's message suggested increases in payroll taxes for both the pension and the unemployment compensation program. This is a penalty on employment. The bigger the payroll, the bigger the tax. Every time you raise wages, the bigger will be the tax. Every time you add a worker, the bigger will be the tax. This is a very tough problem, and I don't know really what the answer is, but we should not put penalties on employment, on job making.

To push in a little additional program here, and a little program here, and have people retire at 62, when we are so concerned with faster growth, this seems to me to be wrong. We knew this would happen. We predicted it when women were allowed to retire at 62; it was inevitable that we would do the same thing for men, and to keep pushing these programs in, I am certain it will only be a matter of a few years until you will say "Well, we won't reduce their old-age and survivors' insurance benefits actuarially," as the new President has proposed, and I think correctly. If they are going to retire earlier, say at 62, they ought to suffer a little penalty on their pension. But in a few years, critics will say, "Why should we penalize these fellows? They are just as hungry and they have as big backs to cover with clothing, etc., and they ought to get the full pension."

Then the actuary will say, "But you have to raise the social taxes." We are getting to the stage where we are overloading our payrolls pretty heavily with taxes. There are a great many fringe benefits tied to wages and jobs. So you have to look at all these things, if you are really worried about unemployment, and I think all of you are. It is a problem for the period ahead. You have to think about whether this payroll cost buildup is the right route to follow.

It is the same with minimum wages. I cannot understand how anybody could think that a recession is a time when you ought to raise the price of labor. You certainly don't guarantee a worker a job when you raise his price. If you have unemployment at existing wage rates, other things being equal, when you raise the wages you must have more further unemployment.

A higher minimum must have some disemployment effects. At a time particularly when the President has so admirably, in my judgment, urged the importance of cost control, to inject this additional factor to push up the entire wage structure by pushing up the minimum—I just can't reconcile this. One has to remember, too, that when you force up the minimum, that isn't where it stops. Wage differentials play a very important role in the allocation of manpower. Wage differentials are highly prized by workers themselves. If you push the minimum up, that overtakes somebody else that gets $1.10. He obviously has to be pushed up to $1.20 or $1.25, and that overtakes a third grade of labor, and so his wage has to go up. This has been historically true. There has been some narrowing of the difference in the last 100 years between skilled labor and unskilled, but generally, a rise at the minimum ripples upward.

So you can't simply be concerned with raising the minimum wage in terms of the impact at the minimum.

Furthermore, I thought the President made an unfortunate slip when he said that this will not affect our exporting business. This is really not good analysis. In the first place, some of those industries do have low-paid workers, and when the minimum goes up it will have this ripple effect, with some lag, to be sure.

In the second place, all of our export businesses are buyers of other parts, components and so on, where wages at the minimum may be pushed up very substantially by the law.

So to say that four-fifths of our exports will not be affected by raising the minimum is not a complete analysis.

I have a great many other points in here of this type, and I hope if you think it is worthwhile, which is rather doubtful, you might read this over later on.

A good illustration of the kind of thing I am talking about was the cutting of the FHA interest rate from 5¾ to 5½; instantaneously the discount on mortgages fell by 2 percentage points. It has happened right along. The interest cut was self-defeating. In other words, you can't manipulate people by dictating the interest rate. The interest rate prevailing in a workably competitive economy is the result of the decisions of millions of savers and borrowers and lenders and so on. It was very interesting to me to see that the minute this interest rate cut was instituted, perhaps even without authority to do so, the discount rate on mortgages went up by 2 percentage points.

There is one other point that I thought was a little unfortunate when the President talked about financing old-age and survivors insurance and unemployment compensation on a "self-supporting basis." Now this is not good semantics. All this really means, and I am sure some people don't understand this, is that this is outside of the conventional budget.

These are financed via trust funds accounts. Well, all government, except deficit spending activities, is on a "self-supporting basis." You tax, and then you pay the Senators and the Congressmen and you pay the various other expenses of the Government and it is "self-supporting" in that sense, and to say that this expansion in unemployment insurance is self-supporting is really not good semantics. All it means is that it is outside the conventional budget and the money has to be levied against the payrolls and paid ultimately, I suspect, by the consumer, via the employer, however.

The last part of my statement deals with the balance of payments and I felt that it would have been much better if Mr. Kennedy had introduced this balance-of-payments statement first, and then his economic message of February 2. We are really in an international bind.

It was gratifying to notice the importance that he placed on cost-cutting and on keeping ourselves competitive with producers abroad and our problem is to be competitive at home as well as abroad.

I could not follow his arithmetic on what he called the "basic deficit" of $1.5 billion. I don't think that this is right, but I am not prepared to defend my position, because he did not spell out how he got this figure of a basic deficit of $1.5 billion.

As nearly as I could see, he based it on our export-import goods and services position, of 1960. But we had an unusally large trade surplus last year which may not endure. There was a very large increase, as you know, in aircraft and cotton exports. I am not sure that these will continue, and in fact I have already been informed by a number of groups that these will not continue, and therefore you can't base the diagnoses of your problem on a short-run, perhaps overstatement of our export surplus.

Also, the statement made on the International Monetary Fund I think is questionable. Mr. Kennedy used a figure of $4.1 billion, but we can only draw 25 percent without question. For the next 25 percent we have to show a little more evidence of need, and so on. Yet Mr. Kennedy implied that we could draw the whole $4.1 billion needed due to our gold losses, and so on.

I would suggest that you take a look at the conditions under which we could draw the other 50 percent. They are really formidable. We would have to, you as members of the Congress would have to, bow to the orders of the International Monetary Fund.

If the Fund decided that our fiscal and monetary policies were not proper, our appropriations were not proper, and our spending programs were not proper, they could say so and disallow us from drawing that extra 50 percent.

I would think, Mr. Chairman, it would be worthwhile if you can find half a dozen really competent and objective scholars to have separate hearings on this message of Mr. Kennedy, and the general problem of the gold losses, and so on.

Just for the record, I notice in the hearings which you held last December on the general economic conditions, the former chairman, Senator Douglas, made this statement in introducing a witness.

> I guess we are all awaiting with great expectation to hear the remarks of the next participant, the foremost authority in this country, possibly in the world, on gold and gold movements, Professor Triffin of Yale University.

Well, this is very high praise for Mr. Triffin, and certainly he merits a hearing, but he represents a very small minority of the views and he may not be in quite the class that the Senator placed him.

Mr. Per Jacobsson, managing director of the International Monetary Fund, who I think most of us would agree has few peers in this field of international monetary movements, currency, and gold and capital flow, and short-term and long-term money markets—I don't know of anyone who has the grasp of the nature of the monetary market which he has—but he said: "I must tell you frankly, that personally I cannot see any value in Dr. Triffin's scheme as such"——

That is the scheme that would make you, as Congressmen, the Federal Reserve, and the Treasury, subservient to the International Monetary Fund by creating an international currency to which our dollar would be subsidiary—

Jacobsson said:

> I must tell you frankly, that personally, I cannot see any value in Dr. Triffin's scheme as such; on the contrary, I believe it can be positively harmful. I use these words deliberately, firstly, because they do represent my considered opinion, and secondly, because I think that attention may be diverted harmfully from the real causes of our imbalance in international affairs, to an impractical scheme which in any case I am sure will never be adopted.

Then he went on to deny what Triffin assumes, and that is a deficiency of international liquidity for the world as a whole.

With the growth of the Common Market, that may reduce, to some extent, the need for gold on other types of liquidity.

Another disappointment in this balance of payments message was the failure of Mr. Kennedy, and this is my last point, to use this opportunity to suggest to you people and appropriate other congressional committees, that we amend the Employment Act of 1946 which has excellent goals, with one omission, and that is the integrity of the dollar. I mention this because I think if we did this, if we took the time and trouble to get it through the Congress, and the President signed it, that this is one of the goals, the integrity of the dollar, and not stable prices but general price stability, or however you want to define it—this would serve notice on the whole world that we are not going to be careless, inflationarywise, and we are not going to devalue, and so on, because if you just keep announcing that we are not going to devalue, well, this has been customary for ministers of finance to announce it up to midnight of the day before devaluation. I don't think that we will do it and certainly not in the near-term future, but I think this would allay a great deal of fear if there is a great deal of fear, and I am not sure that there is, even though there is some.

So I again would urge that your committee think seriously about whether the Employment Act of 1946 could be usefully amended by adding this additional goal, of the integrity of the dollar, without in any way minimizing the other goals in the act.

Thank you, Mr. Chairman.

The CHAIRMAN. Are there any questions?

Mr. Reuss?

Representative REUSS. I agree with you, Mr. Schmidt, that the Employment Act of 1946 could well have an explicit statement that reasonable price stability, to use your phrase, is a goal of national policy. As a matter of fact, I sponsored such a bill, and Senator Clark had a companion version of it in the Senate, in the last Congress. It was favorably reported out of committee, the Government Operations Committee, but it got stuck in the Rules Committee and never got out.

You are familiar with the reform of the Rules Committee while I don't know what position the Chamber of Commerce of the United States has taken on this matter, I hope you share my joy that bills like this will now be able to come out on the floor and that the House will now be able to act on them.

Mr. SCHMIDT. We don't take positions on how Congress organizes itself, except in terms of broad questions like better appropriation procedures, and so on. I would just make one comment. I prefer my language to yours, because I don't think that we ought to talk about reasonable price stability.

Representative REUSS. What was your language?

Mr. SCHMIDT. To some people that means that steel ought to be the same price and vegetables and potatoes ought to be the same price. Free prices and price movements have a very important function and it misleads people to talk about "price stability."

What you want is a phrase like the integrity of the dollar, or the average level of prices, which is the equivalent of the purchasing power of the dollar. This type of language helps to avoid this motion that "Well, somebody is going to use this law to fix prices."

Of course, stable or fixed prices of potatoes, or steel or automobiles or whatever it is, that is a different thing. This is not a minor matter.

Representative REUSS. Reasonable price stability was the phrase used by President Eisenhower and I certainly wanted to be bipartisan on that.

Mr. SCHMIDT. The Economic Report uses, too, the language in not as useful a way as it could be done.

Representative REUSS. I want to commend your general suggestion that this committee could do a useful thing educationally and otherwise by holding hearings on problems of the balance of payments in more detail than have been held, and specifically your suggestion that a presentation of the opposing views of Professor Triffin and Dr. Jacobsson before this committee would be illuminating.

I would hope we could get that. However, I want to read a bit from the letter of Dr. Jacobsson which you quoted on page 13 of your paper: Dr. Jacobsson says to the chairman of this committee, "If you would like to hear in detail my reasons for the opinions I expressed, I suggest that we have a private dinner or luncheon together."

That is one of the difficulties, of course, with being managing director of the International Monetary Fund. I would hope, however, that this committee could get good exponents of both views, because I agree that this is a very important question.

Mr. SCHMIDT. Maybe you could get around the difficulty of getting him before this committee by inviting him to give a speech to some group on the general problem, then you get his careful analysis of those views.

Representative REUSS. That is a very good suggestion.

Now let me take up a couple of points among your remarks on the balance of payments.

Mr. SCHMIDT. I don't profess to be an expert and so don't invite me to be one of these half dozen people.

Representative REUSS. I wondered about this: You seem to be saying that we should not let long-term interest rates decline because this will cause a shift of capital from the United States into foreign investments.

Mr. SCHMIDT. I just raise it as a possibility. I say I don't want to be dogmatic, because I don't really know whether this would be the effect or not, but if we did force down the long-term rate and the long-term rates are the earning power of funds, or the prospects for the next 5 or 10 years abroad, I think funds would move abroad, and this is what Mr. Kennedy wants to stop. He wants to lure long-term funds over here, as well as short-term funds, and this could help to reduce the flow of foreign funds to the United States. This is all I was trying to say.

Representative REUSS. We have to make up our minds on whether it isn't better to get a faster moving economy in part by lowering interest rates, in which the opportunities for profit will attract both foreign and domestic long-term capital, rather than to have a higher set of long-term interest rates which may produce economic stagnation here.

I think that this is a decision that has to be made. My own view is that the national interest is better served by lower long-term interest rates, and that the amount of American long-term capital that is going to desert us and move abroad for the long term for this reason is not very crucial.

At any rate, this is an important point, and I hope that you and the chamber may on further consideration, perhaps in connection with hearings by this committee, conclude that on balance we really are better off, even with respect to the balance of payments, with a lower rather than a higher interest rate structure.

I wanted to take note of this incipient disagreement, although you were very tentative and nondoctrinaire.

Mr. SCHMIDT. I wouldn't want to be dogmatic about it. The interest rate is of less importance in terms of an expanding economy than is the profit expectation, because if the profit expectation is good, say a new venture, making boats or whatever it may be, whether you pay 4 or 5 or 6 percent may not be crucial. Interest costs are tax deductible.

In a marginal case it is important and in the very long-term investment like a house or probably public utilities, also. But for most business borrowing all you have to do is raise the return on the equity by a few percentage points to fix that.

Representative REUSS. Let us do that. Let us make it more attractive for both foreign and domestic capital rather than raise long-term rates, depress housing, and discourage State and local borrowing.

Mr. SCHMIDT. I have never defended high or low interest rates, and I think that the money market ought to be a functional mechanism, the same as any price in any market ought to be the allocated function. A high interest rate is not necessarily bad, per se, nor is a low rate necessarily bad. The market really ought to be the guide.

Representative REUSS. I want to mention one other point on the balance of payments because here, too, I have my doubts.

You seem to say that if we approach a fuller rate of employment and use of our resources, we will then have a higher income, and this will increase our imports. If we build more homes and buildings, we are going to import more plywood and cement, you say.

It is, of course, true that the state of our economy affects both our imports and our exports. However, here again it seems to me that we have to make up our minds. I would be in favor of expanding the domestic economy, and if that means, as it probably would, that we would import more, so be it. Let us try to export more and balance it that way.

Mr. SCHMIDT. I would share your leanings very strongly. All I say is that this thing is not mechanical and you get some side effects from various things that are proposed which you may not anticipate.

Representative REUSS. I am glad to have you explain it in that way, and that removes most or all of my objections to what I thought you were saying, because I don't think that it would be good for the country to avoid trying to get toward full employment and fuller production for fear that this would increase our imports. I am glad you aren't saying that.

Mr. SCHMIDT. No, if I were in a responsible position, I would certainly put the domestic economy ahead of questions of gold losses and things of this kind.

The CHAIRMAN. Are there any questions?

Representative WIDNALL. I would just like to thank you for the instructive comment you made on many things in the economy, and particularly thank you and call to the attention of the committee your remarks in your prepared statement, which you did not go into as you were briefing the whole thing. There you speak about the statement of business bankruptcies as being the highest since the great depression and then call attention to the fact that the percentage is very much lower because there has been a rise of 47 percent in the number of small businesses since the great depression.

Now here again we have that misleading figure, that is used in connection with steel production, where it is related to capacity, and they don't tell how the capacity has changed but relate the percentage of production to the increased capacity.

Here we have a 47 percent more business community than we had back in the time of the great depression, and just about the same number of failures as at that time. I think that this should be brought to the attention of the American people rather than the very glaring and alarming statements that are made.

Mr. SCHMIDT. Yes; I agree with you. You can pick soft spots or trouble spots in almost any situation.

I am just saying that what we need is a balanaced view of the statistics and the conditions of the economy, and I don't thing that we are in such profound and deep trouble as has been portrayed. Althought we do have trouble and I think we will have some difficulty because of the change in the structure of our labor force in the period ahead to provide enough jobs.

Senator PROXMIRE. Mr. Schmidt, you indicated considerable optimism about the future and indicated you felt that some of the analyses we had here, at least one we had here, might be a little pessimistic. Now I would like to ask you this question in view of the statement not by Mr. Reuther, but by Ewan Clague, Commissioner of the United States Bureau of Statistics of the Department of Labor, just to maintain the present level of employment, and not to increase unemployment, but to maintain the 6.6 percent level, you would have to increase the gross national product by $20 billion during this year.

Now, I would like to ask you in view of the fact that there is no accumulated war demand at least in my judgment and we have worked most of this off from the Korean war and World War II. The technological changes have been emphasized by both Mr. Clague and Mr. Reuther and others. The labor force has grown. How can you feel that this is not the time for decisive action or for the President moving ahead as he has indicated in his economic message?

Mr. SCHMIDT. I don't think that I expressed either here or in the manuscript any optimism on what you might quote as attaining full employment, whatever that may be, 95 or 95½ percent.

Senator PROXMIRE. As I understand, you said from 4 to 5 percent unemployment might be tolerable.

Mr. SCHMIDT. I would prefer to tolerate less, but maybe that is the figure that we ought to start from. Whether we will reach that level by, say, the end of next year or, say, a year from now, I would say we would be doing very well if we reached that level of unemployment, only 4 or 5 percent unemployment, with the growth, as you say, in the labor force that is head of us.

But this puts, I think, a tremendous importance in innovation and finding new ways to absorb talent, and not just workers, and not just laborers, but engineers and executives and people that come out of the University of Wisconsin that can become self-employed and become jobmakers—these are very important people in terms of the innovations and the dynamism of the economy. I think the premium has to be put on new product development, and research and we ought to go slowly on putting any penalties on the jobmaker.

Senattor PROXMIRE. Well, that will lead me to my second question. You indicated that you opposed, or you put it in a negative way, that you oppose an additional tax on pensions and I presume that you would oppose the health insurance tied to social security proposals, and the unemployment compensation increase as the President suggested, and you also indicated you oppose the increase in minimum wage, and it seems to me that these were proposals that are aimed at long-range correction of our economy to provide greater purchasing power.

I take it that your answer is that you feel that this is not the way to solve either a recession or a long-term secular downtrend; that the way to do it is to encourage efficiency, innovations, and proceed in that way. Is that right?

Mr. SCHMIDT. Yes, if you look through our history, and when you think of the contribution that a Carnegie made, or an Edison or Henry Ford made, this is the kind of thing that we ought to be searching for. We never know where these people are that might give our economy new strength.

Now, the point I was making, Senator, was that if you raise the social taxes, they become an additional cost of employment and the businessman, or even the housewife, if she has help around the house or yard, is always trying to minimize her outlays, and maximize her returns. If a factor of production is more costly in one form, and less costly in another form, you tend to substitute the less costly input.

Senator PROXMIRE. Yes, but these costs are also a matter of income, and they are a matter of rapidly spent income particularly social security, and the President, as I understand, has proposed or is considering a proposal to increase social security payments, particularly in lower brackets by $10 a month. He has considered other expenditures that would increase the purchasing or increasing spending very rapidly by the consumer.

Now it seems to me that it isn't fair or it isn't a balanced analysis to view these only as costs, and fail to recognize the fact that unemployment compensation money is spent at once because it has to be, and social security money is spent at once because the recipient has to live and you are sure he is going to spend it.

Mr. SCHMIDT. I agree, you have to look at income as both cost and purchasing power. But I think that you ought to determine the social security program on its merits rather than as an antirecession device or raising pension benefits for that purpose while we are in a recession.

Senator PROXMIRE. I would like to say one of the reasons I interrogated Mr. Reuther as I did is that I feel that if you attempt to solve a recession by trying to predict whether you are going to have a recession 5 or 6 months ahead I think it does not work because our economists cannot predict that way.

Therefore, I think that the social security proposal, and unemployment compensation proposals are permanent, and I would view them as such, and I would vote for them or against them on that basis.

Mr. SCHMIDT. They certainly ought to be handled on their own merits, rather than on the recessionary basis.

Senator PROXMIRE. I have one other question, or two other questions.

One, you say the recession is not time to raise the price of labor by increasing the minimum wage. Have you or the chamber ever proposed or favored an increase in the minimum wage at any time, recession or any other period?

Mr. SCHMIDT. No, as an economist I can't go along with that kind of thinking, because what you really are saying to the worker is this: "You cannot take a job unless you can find an employer who is willing and able to pay that minimum wage, which Congress or the State legislature has fixed. You are barring workers from jobs. We know that the bulk of the unemployment is at the lower wage levels, except for, let us say, some steel workers or automobile workers, temporary, perhaps, but the great bulk of the unemployment is at the unskilled level. So they will be hit hardest by raising the minimum from $1 to $1.15.

Senator PROXMIRE. Once again, this in high-velocity money, though, and people who are earning $1 an hour, they spend it and you know they do.

Mr. SCHMIDT. Yes, those who get the jobs and the higher pay, they will spend the money. But I would certainly think that there would have to be some disemployment effects of this.

Senator PROXMIRE. You feel this on the basis of experience? Haven't we had greater proportionate increases? This is a substantial increase that the President has asked. But in the past we have gone from 25 cents to 40 cents, and 40 cents to 75 cents, and from 75 cents to $1. I have seen no analysis indicating this was resulting in disemployment.

Mr. SCHMIDT. Oh, yes, we went through that very carefully, because I have testified a dozen times before the various congressional committees, and one time I testified for 5 hours before one of the House committees on this very subject. You cannot get the statistical evidence as clean as you would like it, because there are always other factors working, and there may be an inflationary force working.

For instance, the last minimum wage went into effect in March of 1956. Prior to that we had a virtually stable Consumer Price Index for 4 years. But since 1956 the index has been going up in more months through the whole period than it has remained stable.

Senator PROXMIRE. You are talking about the price level?

Mr. SCHMIDT. The Consumer Price Index. We have had more unemployment since then, too. This is the period in which we have said that there has been an unduly large percentage of unemployed.

Now, I can't persuade myself that the cost of labor has not got something to do with the usage of labor. Certainly the cost of aluminum or the cost of glass, or iron, or whatever, has some relation to the effective demand. Labor is not a commodity but the service of labor is a commodity in this sense.

You don't hire people except as they produce for you. This is true whether you are a Congressman or a Senator, you don't hire people around your office unless you expect some results from their work. If you doubled everybody's salary, but you had a given appropriation for running your office, you would be able to hire only half as many people.

Senator PROXMIRE. I agree with you on that point. There is no question that an increase in wages is a cost, and unless the productivity increase exceeds the wage increase, you are bound to have a cost increase which will probably result in the long run in a price increase.

I am talking about this, however, in terms of the effect on long-term purchasing power as being a counterbalancing factor.

I have one more question, and I apologize to you for detaining you: You criticized the proposal to reduce FHA interest rates. You also indicated that you felt that interest rates should not be manipulated. You raised a question, both in your formal statement and your informal statement, that interest rates are the result of the performance or activities of millions of savers and borrowers.

Now, I would like to ask you, if it isn't true that the Federal Government and specifically the Federal Reserve Board, does control the supply of money, and as an outstanding economist, don't you recognize that the price of money, which is interest, is a product of the supply and the demand? The Federal Government can increase these things by perfectly obvious action. They can, therefore, diminish the price of money and diminish interest rates or increase the interest rates. They have done so directly over the past, consistently.

Mr. SCHMIDT. I don't think it works that way. This would take a long time, I am afraid, Mr. Chairman, to argue this out, but the Federal Reserve is marginal in influencing interest rates. It is only part of the supply of loan funds. Now, when we hit a recession, it becomes a major, and not the predominant, but a major part of the supply of loan funds. If you examine 1949, 1954, 1958, you will find that the increase in loan funds via the commercial banking system increased in those years. In normal years about 7 to 15 percent of the loan funds are made available via the commercial banking system.

Certainly the Federal Reserve can influence the lending power through the control of the reserves of commercial banks, but in the long run the interest rate is a kind of a natural phemonena. It is part of the nature of people's behavior and expectations. The reason a dollar a year from now is worth less than a dollar now, is because of time preference. I prefer to have a dollar now rather than a dollar a year from now. If you offered me a choice of a dollar a year from now or a dollar today, I would say "By all means, you will have to give me $1.05 a year from now if you want me to lend."

Senator PROXMIRE. I know demand for money is a very important element, as the demand for any other commodity is. But the Federal Government has control over the supply. This is the only way in which any institution can consciously effect interest, deliberately and in a planned way, and the Federal Government has consistently done it ever since 1914, and has again and again reduced interest rates or increased interest rates, and you indicate that they might possibly be able to do it on page 6 of your remarks.

Mr. SCHMIDT. I think we are talking in part about different things. There is a great difference between the money supply in the economy as a whole and the loan funds.

Now, normally something like $60 billion a year is borrowed. That is $60 billion a year, I am guessing now and maybe I am wrong by $5 or $10 billion. But it is something of that order. This has really nothing to do with the money supply as such in the economic system. I use the money supply in the sense of the currency you and I carry around in our pockets, the currency that the businessman has in his till, and the checking account (demand deposits) that you may have or business has. That is the money supply.

If you dehydrate the economy like we did from 1929 to 1932, you help to create deflation. We destroyed 40 percent of our time deposits. We literally dehydrated our economy of the money supply, and this is what caused this powerful deflationary force, and it was the major cause of the Great Depression.

But loan funds come via insurance, pension funds, and building and loan associations, and all of the other great financial institutions, and that is where the great bulk of the loan funds come from. They are borrowed and the commercial banking system is peripheral in this sense. It is very important to distinguish and there is a lot of confusion between the supply of loan funds on the one hand, and the supply of money. They have no necessary relationship to each other.

Senator PROXMIRE. May I just conclude, Mr. Chairman, by saying that we have had testimony here today, I believe by conservative economists who say that the one instrument the Government can use and should use is monetary policy.

Mr. SCHMIDT. In cyclical fashion, I would agree.

Senator PROXMIRE. Whether it is cyclical or not, the fact is if you use it you act in such a way as to increase or decrease the interest rate. That is all I am arguing about.

Mr. SCHMIDT. I would not agree with you on the secular, because that would have to be determined separately, but on the cyclical, I would agree. When expenditures are going forward and people are building up assets and overdoing things, that is when we ought to have a constraint.

Senator PROXMIRE. All I have been saying in this colloquy, Mr. Schmidt, is that you can do it. You just tell me how.

Mr. SCHMIDT. They can't peg them.

Senator PROXMIRE. They did peg them, as a matter of fact.

Mr. SCHMIDT. Oh, no.

Senator PROXMIRE. They pegged them at about 2 percent and there wasn't any question about that.

Mr. SCHMIDT. No, they can't do it.

Senator PROXMIRE. I won't detain you any longer and I appreciate the opportunity of discussing it.

Representative GRIFFITHS. I would like to ask you the same question I asked Mr. Reuther: In your judgment could sales abroad by American industry be appreciably increased if the American Government guaranteed industry against unusual risks, that is, the credit risk that would be involved where it was a developing country and they had a tremendous inflationary program?

Or the seizure of the property. Do you think that American sales abroad, I mean sales abroad by industry located in this country, would be appreciably increased if we guaranteed them against those losses?

Mr. SCHMIDT. I would think so. But it might require a pretty high premium with the revolutionary ferment that is prevailing in much of Africa and Latin America. I don't know what the premium rate would be.

Representative GRIFFITHS. Would that be a legitimate risk of the Government? Would it be legitimate to share or assume that risk?

Mr. SCHMIDT. I would have to think in geopolitic terms before I could answer that question.

Representative GRIFFITHS. Well, we need to sell to them.

Mr. SCHMIDT. But the economists will tell you that the only gain from foreign trade to a nation as a whole consists of the imports, and not the exports. So what you are doing is pushing goods out. We cannot use the goods we push out, so in terms of our own narrow self-interest, the gain from foreign trade consists of the imports and not the exports. So by putting an extra premium on exports, I am not sure that it would help us.

Representative GRIFFITHS. We are not going to import unless we export, are we?

Mr. SCHMIDT. Yes, in the long run, that is right.

Representative GRIFFITHS. You either export goods or money.

Mr. SCHMIDT. You have to have them in balance unless you make loans or pay with gold, if you release the gold.

Representative GRIFFITHS. Would you ask some of your members that question?

Mr. SCHMIDT. I will ask and see what they think.

Representative GRIFFITHS. Thank you.

The CHAIRMAN. Mr. Schmidt, I want to invite your attention to some facts in answer to your statement that the interest rates cannot be fixed. Now I desire to invite your attention to the fact that from June 30, 1939, to March 4, 1951, 12 years, the interest rates on Government obligations never exceeded 2½ percent. During that time Government bonds never went below par. That was 12 years. Now if it can be done by our money managers over a 12-year period in such an awful time as that, it can be done now. In the first 6 years we were in war, in that period, from June 30, 1939; and the next 6 years we were spending as much as a quarter of a billion dollars a day, shooting it away on the battlefield. There were tremendous inflationary pressures and we did not tax nearly as much as we should have. Then—the last 6 years—that was after the war when people had plenty of money and liquid assets—there was a tremendous postponed demand for things that could not be had during the war years—automobiles and other goods. That was the worst time in history for ruinous inflation.

Notwithstanding these conditions, the interest rates on Government bonds, long-term Government bonds, never exceeded 2½ percent; it seldom reached 2½; and Government bonds never sold below par.

Now, I think that is a wonderful record. If it can be done in times like that, it can be done any time. That is my thinking of it.

Mr. SCHMIDT. Well, you see that is, I think, basically wrong. Supposing I ran a filling station——

The CHAIRMAN. Don't suppose anything, but just take those facts, please, and say what is wrong with them.

Mr. SCHMIDT. That is exactly what I am going to do. Suppose I ran a filling station and you drove your car in there and asked for 10 gallons and I gave you 6 and charged you for 10. That is what we did during that period you are talking about. The interest rate was actually negative during the whole period and people that saved $1,000 in whatever your first year was, 1939 or 1941, they had only $500 left in purchasing power by 1951.

The CHAIRMAN. You are not avoiding the issue, but you are assigning the wrong cause to the price increases. The question before us is maintaining interest rates.

Mr. SCHMIDT. Oh, no.

The CHAIRMAN. And I say we maintained interest rates for 12 years, and a low rate, under 2½ percent, and we kept the bonds at par and above.

Mr. SCHMIDT. An authoritarian government—and our Government is authoritarian in some things like fixing your salaries—can keep your salary at whatever figure they want, and in that sense they can do the same with borrowing, and if they can't borrow in the open market at the going interest rate, they can force the Federal Reserve to absorb the bonds.

The CHAIRMAN. Why should we have to force the Federal Reserve to do it? The Federal Reserve is a part of the Government.

Mr. SCHMIDT. You have another witness.

The CHAIRMAN. Cannot a part of the Government come to the aid and rescue of its own parent?

Mr. SCHMIDT. I think this is falsification, and I don't mean on your part, but during this period we had the most gross and cruel tax on bond buyers, the widows and orphans and pensioners, and so on, and I don't regard this as a good illustration at all.

The CHAIRMAN. I don't think that you have answered my question. I said during that 12-year period the money managers were working in the public interest, and they never allowed yields on Government bonds to go above 2½ percent. Why can't they do it at any time?

Mr. SCHMIDT. Because we believe in a free economy and because we don't believe that the Government ought to dictate this kind of thing.

Now, if you are really right, you see, why not a zero interest rate?

The CHAIRMAN. We do not want that.

Mr. SCHMIDT. Why not?

The CHAIRMAN. Well, because——

Mr. SCHMIDT. If 2½ percent is better than 4 percent?

The CHAIRMAN. Stick with the facts I gave you; they are good ones.

Mr. SCHMIDT. I agree that the facts are correct, but the interpretation is wrong.

The CHAIRMAN. What is that?

Mr. SCHMIDT. Your facts, I think, are correct, and I would have to check but you know more about this than I do, I think your facts are right. But your interpretation is wrong, because we did this by rooking the savers, the bond buyers.

The CHAIRMAN. Low interest was in the public interest, and that is what our Government is for, operating in the public interest.

Mr. SCHMIDT. I don't believe in theft, in giving a man 6 gallons when he pays me for 10.

The CHAIRMAN. Thank you.

Mr. George G. Hagedorn, of the National Association of Manufacturers.

Mr. Hagedorn, I am very sorry about the lateness of the hour. It was unavoidable. The members wanted to ask questions and we could not avoid the delay. We are awfully sorry. Do you have a prepared statement?

STATEMENT OF GEORGE G. HAGEDORN, DIRECTOR OF RESEARCH, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, D.C.

Mr. HAGEDORN. I have a prepared statement, but I would like to file the statement for your record and summarize it briefly.

The CHAIRMAN. That will be satisfactory, and without objection that will be inserted in the record at this point.

(Mr. Hagedorn's prepared statement follows:)

STATEMENT OF GEORGE G. HAGEDORN, DIRECTOR OF RESEARCH, NATIONAL ASSOCIATION OF MANUFACTURERS

I would like to start my review of the January 1961 Economic Report of the President with two broad comments.

First, in its statement of economic principle, and in its conception of the economic guidelines which should give direction to our national policies, it is eminently sound and thorough. This is especially true of the chapters on "Experience Under the Employment Act of 1946" and "Policies for the Future." These sections recognize fully that the welfare of our economy depends on whether the private profitmaking sector of that economy is flourishing.

My second comment, however, is that the report does not give adequate recognition to the serious obstacles which have been placed in the way of optimum performance by our private business economy. Although the report recognizes that problems exist, its general tone is one of satisfaction with the state of our economy.

I believe, on the contrary, that our current economic difficulties may be more serious and more deep seated than is generally recognized. It would be a mistake to conclude that the general economic climate of recent years is one that we should strive to continue, with only minor corrections, into the future.

In my opinion, President Kennedy's recent statement that "The American economy is in trouble" has some basis in fact. Let me hasten to add that I do not find, either in the statements of President Kennedy or of his advisers, any adequate analysis of the nature or origin of the trouble we are in. Also, such measures as are being proposed by this group seem to be mainly in the nature of provisions for relief of the current distress, rather than correction of its underlying causes.

The bases for the two comments I have just made on the 1961 Economic Report will be made clear in what follows.

GOALS OF THE EMPLOYMENT ACT

I will begin by calling to your attention the chapter which deals with the Nation's "Experience Under the Employment Act of 1946." Although we are all concerned with the current imbalances in certain sectors of our economy, some comment on the progress we have made under that act is valuable in the study and analysis of our present problems.

Initially, it will be useful to recall briefly the tenets which are stated in the Employment Act and the principles which are inherent in its philosophy. The following quotation from the current Economic Report provide a sound and much-needed interpretation of the purpose and nature of the Employment Act of 1946:

"Thus, the Employment Act states that it shall be the policy of the Federal Government to promote conditions under which there will be afforded employment opportunities by methods that are consistent with the traditional American philosophy of individual freedom and competitive enterprise." [1]

* * * * * * *

"The act * * * contemplates a framework in which the mainsprings of private individual initiative continue to function in behalf of brisk economic activity and in which the individual retains a wide freedom of choice. In our economic system, the level of achievement is everyone's responsibility and cannot be guaranteed by the Federal Government acting alone." [2]

"It should be noted, also, that the act states that the Nation's economic objectives should be pursued with due regard to other Federal objectives and obligations, which must include a stable currency and protection of the value of the dollar." [2]

[1] Economic Report of the President, January 1961, p. 46.
[2] Ibid., p. 47.

Thus the Employment Act implicitly accepts the fact that we are a profit-motivated economy and that it is the responsibility of the Government to promote and foster an economic climate favorable for this type of economy. If in attempts to alleviate a specific economic imbalance we pursued policies which discourage private initiative and enterprise, we would be weakening our economic system, which was certainly not the intent of Congress in enacting the Employment Act.

In addition, proposed economic programs sometimes fail to attack the primary causes of our economic problems. In many cases these programs are designed in such a manner that they could at best bring temporary relief or moderation without correcting the underlying condition which brought the problem about. In my opinion, it is more in keeping with the spirit of the Employment Act to seek out and remedy the causes of our economic difficulties, rather than merely to alleviate their effects.

THE UNEMPLOYMENT PROBLEM

As this committee meets, the most urgent domestic problem facing the Nation is the current rate of unemployment. While the problem has not reached the disastrous proportion experienced from 1930 to the start of World War II, nevertheless it is properly a matter of concern. The problem is broad and many aspects of economic activity have an influence on levels of employment and unemployment. While there is not any single magical formula capable of effecting an immediate cure to the unemployment problem, nevertheless an analysis of the conditions which have contributed to the problem is essential if proper corrective action is to be taken.

During the last 2 months the rate of unemployment has been close to 7 percent of the labor force. Probably about one-third of the unemployed are the victims of the current cyclical downturn in economic activity and their plight will presumably be relieved with an upturn in business activity. Of much greater concern is the fact that unemployment was quite high even before the downturn last year.

The heart of the unemployment problem is centered in the roughly 5 percent of the labor force that remained unemployed in the period of peak economic activity that ran from late 1958 through the middle of 1960. Chart I accompanying this testimony shows that during periods of recovery and high economic activity, the percent of the labor force remaining unemployed has leveled off at a higher figure after each of the postwar recessions. While an unemployment rate of 3, 4, or even 5 percent is far removed from the economic stagnation that prevailed in 1933 (25 percent) or 1938 (19 percent), there is a cause for serious concern with the direction this unemployment trend is taking in the periods between recessions.

WHAT HAPPENS TO JOBS?

In seeking an explanation of this situation let us start by looking at the changes which occurred in the total labor force and the shifts which took place in the industrial makeup of our employed labor force.

Table 1, which follows. illustrates the overall change in the makeup of our civilian labor force.

TABLE 1.—*Civilian labor force* [1]

[Millions]

	Total labor force	Employed			Unemployed	
		Total	Agriculture	Nonagriculture	Total	Percent of labor force
1947	60.2	57.8	8.2	49.6	2.4	3.9
1960	70.3	66.4	5.7	60.7	3.9	5.6
Increase	10.1	8.6	−2.5	11.1	1.5	

[1] Economic Report of the President, January 1961, table C-17, p. 146.

Since 1947 we have had an increase of 10.1 million in the labor force and an increase of 8.6 million in the number employed. Actually, there were 11.1 million additional jobs created in the nonagricultural sector, but this was offset by a 2.5 million reduction in agriculture employment. The decline in the demand for farmworkers is largely a result of rapid introduction of technological improvements in agriculture. The demand for agricultural products increases every year with our expanding population, yet we are still overproducing with a declining agricultural work force.

The shifts which occurred in the nonagricultural section reveal definite trends which have altered the employment of our manpower resources. Chart II shows that the construction, trade, finance, service, and Government classifications registered substantial gains since 1947. To offset these gains there were decreases in the number employed in the coal mining and transportation industries and only a slight increase in the manufacturing sector.

Let's look at the industries that experienced declines in employment. The 65 percent drop in coal-mining employment (approximately 330,000 jobs) is the combined result of a shift to other forms of fuel and a high degree of mechanization in the coal industry, both of which developments were accelerated by extremely high labor costs. The seriousness of the situation was intensified by the fact that coal mining is concentrated in certain areas such as West Virginia and Pennsylvania.

The drop in employment in transportation is confined to one industry—railroads. Here competitive forms of transportation have managed to take business from the railroads which have been impeded in their efforts to compete by high labor costs and restrictive work practice rules.

The small net gain in manufacturing employment is the result of various changes within the sector. Table II shows that two manufacturing industries experienced large reductions in employment since 1947. They are the lumber and textile industries which, like the coal industry, tend to be concentrated in certain geographical areas and as a result their drop in employment is especially disastrous to these areas. The employment decline in these industries is due to a number of factors, among which are high operating costs and stiff competition from foreign producers. Not evident in table II is the decline in employment in the automobile industry in recent years. Automobile employment reached a peak in 1953 and since then has dropped by about 150,000, or 16 percent. In their struggle to remain competitive in the face of rising labor costs, the automobile and textile industries have diversified operations and automated many of their productive facilities.

WHY SOME JOBS DISAPPEAR

A reduction of employment in one industry can be evidence of economic progress, rather than of stagnation. All through our history we have examples where employment in certain sectors actually declined while output increased. This is progress in the form of increased productivity. This is what has occurred in the agricultural sector. If we had kept three-quarters of our population engaged in agriculture—as was the case a century ago—we would have lacked the necessary manpower to become the world's leading industrial nation. Actually, in the last 40 years there has been hardly any employment growth in the goods-producing sectors of the economy—agriculture, manufacturing, mining, and construction. By contrast, in the same period the number of jobs in the service-producing sectors has more than doubled.

Attempts to prevent or delay the disappearance of particular kinds of jobs are seldom successful for any length of time and constitute a waste of our national productive powers. We want our economy to provide jobs, but they must be jobs of a kind that will make the most efficient use of our manpower resources. If this is to come about, individuals must have the initiative and freedom to adapt themselves to the industries and geographical locations in which such jobs are available.

IMPACT OF RISING LABOR COSTS

While the elimination of certain jobs such as agricultural work is the result of progress, there are other cases where jobs are eliminated because the cost of employing people in them has become uneconomically high. If these added costs can be passed on, it is often at the expense of volume of production and hence of employment. If the added costs cannot be passed on in higher prices, profits are reduced, and this will result in a discontinuance of marginal operations which might have been just barely profitable, thus also reducing employment.

A statutory increase in the minimum wage tends to have this effect on costs with the resulting elimination of jobs. The primary group which would be effected by a raise in the minimum wage is the unskilled class—precisely the people who at present have the hardest time finding employment. Elimination of more of their jobs as they become more expensive to maintain is hardly the way to improve their lot. In addition, the chain reaction caused by a rise in the minimum wage all the way up the wage rate scale might jeopardize the security of higher paying jobs.

TABLE II.—*Manufacturing employment*

[In thousands]

	1947	1960	Change, 1947–60	
			Actual	Percent
Durable goods:				
Ordnance and accessories	27	150	+123	+455.6
Lumber and wood products	842	644	−198	−23.5
Furniture and fixtures	340	389	+49	+14.4
Stone, clay, and glass	505	550	+45	+8.9
Primary metals	1,231	1,186	−45	−3.7
Fabricated metals	977	1,079	+102	+10.4
Machinery (other than electrical)	1,529	1,637	+108	+7.1
Electrical machinery	918	1,305	+387	+42.2
Transportation equipment	1,275	1,641	+366	+28.7
Autos	776	[1] 781	+5	+.6
Other transportation	499	[1] 863	+364	+72.9
Instruments	265	351	+86	+32.5
Miscellaneous	463	501	+38	+8.2
Total durables	8,372	9,432	+1,060	+12.7
Nondurable goods:				
Food and kindred products	1,545	1,472	−73	−4.7
Tobacco manufacturers	118	88	−30	−25.4
Textile mill products	1,335	946	−389	−29.1
Apparel	1,132	1,216	+84	+7.4
Paper	465	562	+97	+20.9
Printing and publishing	711	894	+183	+25.7
Chemicals	694	875	+181	+26.1
Petroleum and coal products	239	229	−10	−4.2
Rubber products	270	259	−11	−4.1
Leather goods	409	365	−44	−10.8
Total nondurables	6,910	6,906	−12	−.2

[1] 10-month average.

Source: U.S. Bureau of Labor Statistics.

Since 1947 periodic increases in labor costs have become an accepted routine. As a result, average labor costs per hour for the private economy increased by 102 percent between 1947 and 1959. This was partially offset by gains in productivity so that labor costs per unit of output increased by a lesser, but still substantial, figure of 37 percent.

The restrictive influence on employment of this cost rise would have been even more serious except for unusual economic circumstances. During the years immediately following the war the heritage of wartime savings and unsatisfied needs insured a level of demand high enough to bear the added cost. The Korean war also contributed another unusual stimulus to the economy. During most of the postwar period, in fact until fairly recently, our economy was not faced with serious competition from the other industrial nations of the world, which had not rebuilt their economies to the point where they had a substantial surplus to export.

These special circumstances no longer exist and we must face squarely the job-destroying effect of rising labor costs. I firmly believe that there is a direct relation between the increase in the number of unemployed and the persistent upward trend in the cost of labor.

THE CREATOR OF JOBS

Now that we have seen what factors eliminate jobs we should consider what factors create jobs. Since 1947 the nonagricultural sector shows a net increase of 11.1 million jobs. Why? Mainly because certain people believed that a profit could be made in the production of some product or service which required this added employment. While all sorts of economic, social, and technological factors can influence the prospects for making a profit, the simple fact remains that it is the expectation of profit that creates most of the employment opportunities in our economy.

In general, profits depend on the margin between the price which may be obtained for the product and the cost of producing it. Factors which affect price or costs will affect profits. A squeeze on profits or their elimination will have repercussions on employment. This is the most basic fact to be kept in mind in seeking an explanation for the observed trends in employment.

In reading the Economic Report of the President, it seemed to me that insufficient attention was paid to the deteriorating profit-picture. While much of the text emphasized the fact that we are a profit-motivated economy, the relative lack of concern over falling profits surprised me.

In every recession since World War II, the record will show that the drop in production and the drop in employment was preceded by a fall in profits. Some 90 percent of our production of goods and services originates in profitmaking sectors of our economy and the profitmaking sectors account for about 89 percent of a civilian employment. These activities exist solely because they offer the possibility to make a profit.

The tendency to regard declining profits as a result of economic sluggishness arther than a cause is a serious error. To disregard the true function of profits as the driving force in the expansion of growth and employment, and to regard profits as a sort of "surplus value" that may or may not occur depending on business conditions, is a misconception which could be fatal to our economic system. The plain truth is that unless there is a reasonable expectation of earning a profit, there will be no expansion of job opportunities.

THE PROFIT PICTURE

Since the profit record failed to receive proper attention or analysis in the Economic Report, I would like to insert table III which presents the record of corporate profits between 1947 and 1960.

The record is quite discouraging. Between 1947 and 1960 the gross national product increased from $234 billion to over $500 billion; i.e., it more than doubled. Profits before taxes increased by just about 50 percent. Profits after taxes increased by a little more than 25 percent. Thus, profits have fallen far behind the growth of the economy.

Profits after taxes fell from 7.8 percent of the gross national product in 1947 to 4.6 percent in 1960. In addition to the cyclical fluctuations upward and downward, there has been a persistent downward trend in this ratio. Need we look further for the cause of unemployment and the failure of the private sector to supply enough jobs for the labor force?

If we regard the declining profit situation as a cause rather than a result of economic recession, then we have a key to measures for correcting economic sluggishness.

TABLE III.—*Profit record, 1947–60*

[Billions of dollars]

Year	GNP	Profits before tax	Profits after tax	Profits as a percent of GNP	
				Before tax	After tax
1947	$234.3	$29.5	$18.2	12.6	7.8
1948	259.4	33.0	20.5	12.7	7.9
1949	258.1	26.4	16.0	10.2	6.2
1950	284.6	40.6	22.8	14.3	8.0
1951	329.0	42.2	19.7	12.8	6.0
1952	347.0	36.7	17.2	10.6	5.0
1953	365.4	38.3	18.1	10.5	5.0
1954	363.1	34.1	16.8	9.4	4.6
1955	397.5	44.9	23.0	11.3	5.8
1956	419.2	44.7	23.5	10.7	5.6
1957	442.8	43.2	22.3	9.8	5.0
1958	444.2	37.7	19.1	8.5	4.3
1959	482.1	47.0	23.8	9.7	4.9
1960 (estimated)	503.2	45.0	23.0	8.9	4.6

Source: Economic Report of the President, January 1961, tables C–1, p. 127; C–57, p. 192.

RESTRAINTS ON PROFITS

Since profit is the differential between selling price and cost, it stands to reason that, if we are to have high levels of employment, increases in the unit cost of production should be avoided. Currently there are several factors which tend to raise wage and fringe benefit rates to uneconomic levels which destroy jobs. The monopoly powers certain unions hold over entire industries make it difficult, if not impossible, for employers to take a strong stand against unearned labor cost increases. In addition there are such factors as the public toleration of infringements on personal liberties and property rights by unions, and the support given to unions by Federal law and regulations.

In recent years the whole tendency of our economic climate has been toward creating a bias in favor of the forces which tend to raise labor costs. This bias is embodied, not only in our laws, but in such less tangible factors as national habits and national attitudes. Perhaps the first step in correcting the bias lies in recognizing that it has the effect of curtailing employment opportunities.

Another heavy onus which cuts into profits, and is therefore a deterrent to the growth in employment, is the present tax burden. Under the present tax-rate structure, corporations generally must earn more than $2 to keep $1 as profit. The penalty imposed on profits saps the vitality needed for economic growth and progress.

For individuals who would invest and embark on profitmaking ventures in the form of unincorporated enterprises, the progressive tax-rate structure which is imposed on them is a serious deterrent. How can an economy which is profit-motivated justify a tax system where the more you earn the less, proportionally, you are able to retain?

Tax revenues are necessary for the operation of the Government. However, the falling tax revenues of the past year show that you can't tax income which is not produced. The success of our economic system is dependent upon the profit motive and if we continue to penalize initiative there will be less and less to tax.

In addition, present income-tax rates impede the accumulation of capital, which performs a vital function in the process of economic growth. Capital investment is the major cause of increased productivity as it provides the existing labor force with better tools. Increased productivity has the beneficial effect of partially offsetting the job-destroying effects of increased labor costs. New investments also make possible the creation of facilities for producing new products.

Capital accumulation must precede capital formation. Our present unrealistic tax-rate structure cuts deeply into the very sources upon which capital formation depends.

THE BALANCE OF PAYMENTS PROBLEM

For several years there has been concern over the deterioration in the balance of payments position of this country. The deterioration continued in 1960 even though we managed to expand our exports. Our drive to increase exports was greatly aided in 1960 by the prosperity of other nations who were able to purchase our goods. A major cause for concern in recent months has been the outflow of private capital, particularly short-term capital.

Since many delicate questions of U.S. relations with other countries are involved, I will not try to spell out here a detailed program for bringing the international payments of the United States into better balance. It is well to note, however, that many of the factors which have been described above as responsible for our domestic difficulties have also contributed to the balance-of-payments problem.

High labor costs and high taxes in this country impair the ability of American producers to compete, both in home markets and abroad. If we attempt to offset the job-destroying effects of increased labor costs by making credit easier in this country, the resulting difference in interest rates here and abroad would cause short-term capital to flow outward at an even greater rate.

I believe that the danger of a balance-of-payments crisis can be avoided, provided we convince the world that we intend to put our own economy on a sound basis through noninflationary measures. But if it appears to the rest of the world that our only means of dealing with domestic unemployment will be through fiscal and monetary "pump-priming," they will quickly lose confidence in our dollar and the crisis will be upon us.

There is no conflict between the objective of noninflationary growth in employment and production at home, and the maintenance of a strong balance-of-payments position internationally. What helps to solve one problem will help to solve the other.

LONG-TERM CHARACTER OF CURRENT ECONOMIC PROBLEMS

It would be a serious mistake to regard the economic difficulties with which we are presently concerned as merely a phase of the business cycle. We may indeed emerge rather quickly from the current recession—or whatever it may be called. But the economic record of recent years gives us no ground for assurance that we will then automatically be back on the track of economic growth and full realization of the Nation's productive potential.

In explaining this conclusion I would like to call your attention again to Chart I. The data shown are the monthly rates of unemployment (unemployment as a percent of the civilian labor force), seasonally adjusted.

The chart is characterized by three peaks of varying height, in 1949, 1954, and 1958 respectively, corresponding to the three recognized postwar recessions. Since mid-1960 the line is trending upward again, apparently toward a new peak although it is impossible to say at this time how high the peak will be or when it will occur.

The major cause for concern in this record does not lie in the recurring recessionary peaks. Our post World War II recessions have been neither severe nor prolonged. At the worst point of the 1949 recession the unemployment rate reached a high of not quite 8 percent. In 1954 the peak was 6.2 percent and in 1958, 7.5 percent. While these levels of unemployment should not be viewed with complacency, they are very far from the levels of mass unemployment reached in the 1930's—25 percent of the labor force unemployed in 1933 and 19 percent in 1938. After each of the recessionary peaks since World War II unemployment dropped rapidly—there was no tendency for unemployment to remain near its peak level for a prolonged period.

The more serious cause for concern is the gradual rise in the level of unemployment in the periods between the recessions. After the 1949 recession, unemployment leveled off at a rate of 3 percent of the labor force. After the 1954 recession, unemployment stabilized at a level somewhat above 4 percent. Following the recovery from the 1958 recession, and prior to the current rise, unemployment averaged well above 5 percent.

Rates of unemployment of 3, 4, or 5 percent are of course very far from levels which could be described as a deep depression. It is the direction and persistence of the trend which is disturbing. The rise in unemployment is the more alarming from the fact that it is not a cyclical phenomenon, but a longer-run trend superimposed on top of the cycles. This should be kept in mind in seeking causes and cures. The problem is not one of ironing out occasional cyclical peaks but of dealing with chronic, cumulative, and persistent economic maladjustments. Such maladjustments have not reached catastropric proportions, but they are trending in the wrong direction.

The distinction between a cyclical problem and a longer-term problem seems to me quite basic for formulating policy. I am somewhat surprised that so many of the suggestions being made for meeting our economic difficulties seem designed to deal with a temporary recession rather than a long-term failure of growth.

For example, the suggestion for a temporary cut in taxes seems based on the assumption that the problem is merely one of getting out of a recession. But in light of the fact that what we really have to deal with is chronic economic sluggishness, what is needed is a major and permanent reform of the tax-rate structure so as to relieve the restriction it places on growth.

Another approach which seems entirely inappopriate is the notion that we can maintain fiscal soundness by running Federal defiicits in recession years, to be offset by surpluses in good years. If, based on this philosophy, we expanded Federal spending to meet the immediate situation, and did nothing else to restore long-term growth, we would very likely find that we had let ourselves in for a long series of deficits.

Also, it is clear that we cannot depend on the so-called built-in stabilizers to solve our problems. These at best can temper cyclical swings, but they cannot deal with impediments to longer-term growth. An attempt to enlarge the role of the built-in stabilizers, as a solution to current economic sluggishness, would be a futile policy. Such an approach would be damaging in the long run since it turns attention away from an attack on fundamental problems.

I very much fear that our problem is more deep-seated and more difficult than any of these proposed solutions would suggest. We need to deal directly with the causes of our situation. As I have indicated, these lie in certain economic maladjustments which have developed. The two chief maladjustments are: The constant tendency toward increasing unit labor costs which places restraints on employment, production, and trade; and a tax system which impedes the accumulation of capital and reduces incentives.

THE "DEPRESSED AREAS"

Most of the regions of the country which are recognized as chronically depressed areas are connected with the industrial shifts in employment described earlier.

The difficulties in the Detroit area stem to an important degree from the decline since 1953 in employment in the automobile industry—plus the fact that there is an increasing tendency for this industry to disperse its operations to other areas. The decline in employment is partly due to changes in technology.

The sharp decline in bituminous coal mining has caused distress in certain areas of Pennsylvania, West Virginia, and other States, where coal mining was formerly the leading industry. The decline in number of jobs in bituminous mining is a compound of the effects of the greatly increased mechanization of the industry and of the loss of markets to competing fuels, both of which are to some degree related to the increase in labor costs in the industry.

Similarly unemployment in the textile towns of New England is the result of the substantial decline of employment in the textile industry. The problem of these towns is intensified by the fact that as existing plants become obsolete the new plants to replace them are often built in other parts of the country.

This raises the question of whether our growth in number of jobs would not have been healthier if it had been spread out more evenly over all the sectors of the economy. Isn't it a sign of something wrong if employment in many industries actually declines while the overall number of jobs increases?

The answer is that economic growth never has been and never can be divided up equally among all types of economic activity. The decline in employment in certain industries is itself a result of general economic growth, and attempts to resist such declines can frustrate growth itself. As already pointed out if we had not learned to get along with fewer people on our farms, we could not have enjoyed the great industrial growth of the past century.

Government measures to reverse, or slow down such declines in employment in particular sectors of the economy are not likely to be successful and are likely to be extremely costly. The lesson of our farm program—both its ineffectiveness and its costliness—should be applicable here. Agriculture is a sector in which employment has been declining for many years. With changing farm technology we simply do not need as many farmers as we once did to feed us. In an attempt to counteract the effects on the farm population of this situation we have embarked on a huge snowballing program involving a number of different approaches, none of which has been able to halt the decline in job opportunities in farming and all of which have cost the taxpayers many billions. We should beware of becoming involved in a similarly hopeless and similarly costly program for rescuing distressed areas.

National measures to encourage new businesses to locate in such distressed areas, rather than elsewhere, are of questionable validity. Why should taxpayers in one section of the country be required to subsidize business growth in another section? Would the net effect of such measures be to reduce unemployment or simply to spread it out more evenly around the country?

Local measures to attract business can be more effective than a national program. These local programs compete with each other and thus improve the "business climate" all over the country. Such local programs, plus national programs for controlling the excessive power of labor organizations, and reforming tax rates, will contribute toward solving the unemployment problem in the country as a whole and in the depressed areas.

RECOMMENDATIONS

Since your committee does not consider specific legislation, I will phrase my recommendations in general terms instead of offering a detailed blueprint for legislation. Action to put our economy back on the track of sound economic growth should be carried out along three lines:

1. *Reduction of the constant and pervasive pressure toward increasing wage and fringe benefit costs.*—This is only partly a legislative problem. It involves not only a reduction in the power and privileges of labor unions, but a greater recognition by everyone that such cost increases tend to destroy the jobs of those who are supposed to benefit from them.

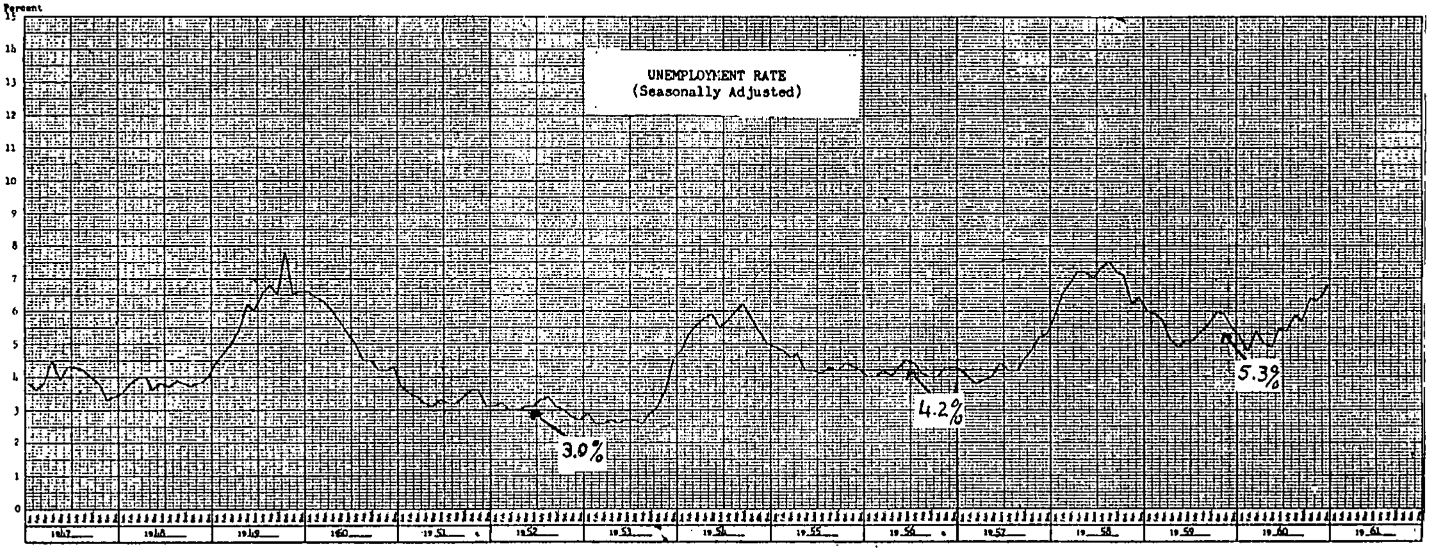
2. *A systematically planned and permanent reform of income tax rates for individuals and corporations.*—The most practical way of doing this is by advanced scheduling of rate reduction, so as to allocate the additional revenue resulting from economic growth to that purpose rather than to increased Government spending. By adhering to a systematic program of this kind, tax rates can be reduced to reasonable levels within a brief span of years. This kind of a program will release funds for the necessary private investment. It would do far more for economic growth than any program of expanded Government spending.

3. *Dependence on local initiative for the solution of purely local problems.*—Federal attempts to solve local problems would launch the country on a program which would be bound to grow in cost over the years, would be futile in the long run, and would put the Federal Government in the untenable position of favoring certain geographical sections at the expense of the rest of the country.

This, in broad outline, is a program for achieving high levels of employment and production. It is in keeping with the Employment Act's recognition of our economy as one based on individual freedom and private competitive enterprise.

66841—61——14

CHART 1

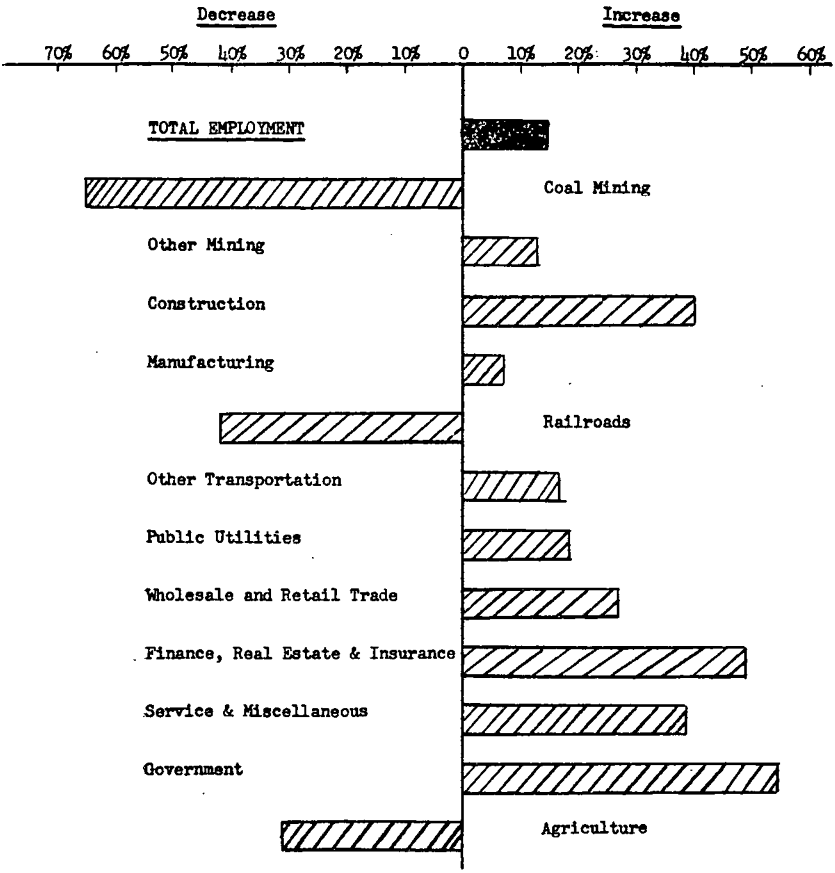


Source: U. S. Department of Labor

CHART II

EMPLOYMENT IN MAJOR ECONOMIC SECTORS

(Percent Change 1947-1960)



SOURCE: U. S. Bureau of Labor Statistics.

Mr. HAGEDORN. In view of the fact that I come at the end of the procession today, and that many of the points that I intended to raise have been discussed already, I think that I will proceed in such a way as to emphasize the points where I may have a new thought that has not been discussed here today.

One part of the purpose of the hearings today is to hear comments on the 1961 President's Economic Report. I want to start with two very broad-gage comments, and then develop these and speak about the current status of our economy in the light of these two broad comments.

My first broad comment on President Eisenhower's Economic Report is that in its statement of economic principles and in its conception of the role of Government and of the role of the private sector of the economy, I think it is excellent and that we should all read it carefully and reflect on it.

It emphasizes the fact that, after all, the heart of our economy is the private sector of the economy, and the question of whether our economic system generally is flourishing depends on whether the private sector of our economy is flourishing.

It also recognizes that the Employment Act of 1946 states clearly that the Government's function of promoting high levels of employment and purchasing power and production should be carried out with full recognition of all of the other responsibilities of the Government and all of the other problems that are of importance to the welfare of the American people. It would be well for us to remind ourselves of this fact when dealing with any specific problem.

My second broad-gage comment on the President's 1961 Economic Report, however, is that in its application of these thoughts to the current state of our economy, it doesn't seem to me to recognize sufficiently the fact that serious impediments can be put in the way of the best performance of our private enterprise economy. It seems to me in particular that right at this time some of those impediments are coming to a head and that we aren't operating at a level of efficiency in our economy that we should be attaining.

The President's Economic Report, although it has some reservations and seems some things need be corrected, takes generally a very optimistic tone about where we stand and where we are going. I think, on the contrary, we ought to look more carefully at some of the difficulties that are developing, because I think that they are more serious than many people generally recognize.

I think it would be a mistake to conclude that our general economic climate in recent years has been one with which we can take satisfaction.

I would like at this point to call your attention to chart No. 1, which is attached to my prepared statement. The most important domestic problem that all of us are worried about is the problem of unemployment, and I think that this chart helps us to analyze the nature of this problem. This chart shows the unemployment rate, that is, unemployment as a percentage of the civilian labor force. It is seasonally adjusted month by month, 1947 through 1960.

At the time this chart was prepared we had not seen the figure of 6.6 percent which has since been released as the January unemployment rate. It goes through December when the figure was 6.8 percent.

Now as we look at this chart, perhaps the first thing that strikes the eye is the fact that there have been four peaks in the unemployment rate. Perhaps I should say three peaks and the present trend toward another peak. There was a peak toward the end of 1949, one in the fall of 1954, one in 1958, and as I just mentioned, the present trend, since about the middle of 1960 the unemployment rate has been trending upward. We are apparently approaching another peak and we don't know when that peak will be reached or how long it will last.

The actual level of unemployment attained at the various peaks were as follows:

In 1949 it was close to 8 percent, and in 1954 somewhere around 6 percent, and in 1958 it was about 7½ percent. These of course are not levels of unemployment that we can refer to with any complacency, but they are far below the level of employment attained in the stagnant years of the 1930's. The 1933 unemployment rate for the whole year was about 25 percent. In 1938 the average was 19 percent.

I would also call your attention to the fact that in each of the postwar peaks in unemployment rates the period during which unemployment remained at that peak level was relatively short.

Also, these recession periods, and these periods of unemployment seem to be connected largely with inventory turns in our economy. It does seem ot me that the more serious problem of unemployment does not lie in these cyclical peaks. I would call your attention now to the fact that after 1949–50 peak unemployment fell and eventually leveled off at a rate of just about 3 percent of the civilian labor force. That is indicated on the chart. After the 1954 recession, unemployment leveled off at a rate of about 4.2 percent. That is also indicated on the chart. After the 1958 recession, unemployment leveled off at about 5.3 percent of our civilian labor force.

So you have a continual upward trend in the level of unemployment in the periods between recessions; that is, 3 percent, 4.2 percent, and 5.3 percent. That, it seems to me, is the more serious aspect of our unemployment problem, and of our overall economic problem.

The problem is not so much a problem of ironing out cycles. The cycles have been brief and they haven't been serious compared with prewar recessions.

We do have a more serious problem in this continual upward trend in unemployment rates between recessions. Apparently we have a chronic underlying and more fundamental economical maladjustment than the inventory swings that are represented in the cycles.

I would like to seek further to identify that basic chronic maladjustment.

Before I go on, let me say that I think it is quite important to distinguish between a cyclical problem and this sort of chronic cumulative problem which I am discussing.

The measures you might take to correct a cyclical problem are quite different from the measures you seek to correct a serious long-range maladjustment. I am quite surprised, at the present time, to see the thought of a temporary tax cut so constantly advanced as a solution to our problem. If all we had to do was to iron out a short-term cycle, a temporary tax cut might have some merit, although I think even under these conditions we would raise questions about its long-range effects. But if our problem is really a cumulative, long-range, slowly developing problem rather than a question of the immediate cycle, a temporary tax cut is not at all the appropriate step in seeking a solution.

I would also like to comment on what is usually referred to as the built-in stabilizers. They too might be helpful in ironing out cycles, and cutting off the peaks and the valleys in our economic swings. But if what we are troubled with really is this long-range type of cumulative economic difficulty, these stabilizers don't seem to be the type of action that will really put us back on the track toward stable long-term economic growth.

Any attempt to correct our present difficulties by expanding the role of the built-in stabilizers again is not attacking the basic causes of our trouble.

Wel, what are the basic causes of this gradual cumulative growth in unemployment? Mr. Schmidt had the explanation in his statement; that is, as you increase labor cases and as you increase the cost of hiring additional labor, you are decreasing the market for labor. The same rule operates here as operates in any other market. Mr. Schmidt developed this thought at great length and I am not going to repeat what he said. It seems as clear to me as it was to Mr. Schmidt that if a person is having trouble finding a market for his services, the worst thing you can do for him is to make it more expensive for business to hire him.

If I may, Senator Proxmire, I would like to come back a little later and discuss the purchasing power thought on which you and Mr. Schmidt had some colloquy.

Senator PROXMIRE. I wish that you would.

Mr. HAGEDORN. Let me proceed on this track. The basic problem leading to slow growth and unemployment is the increase in labor costs. You can document the increased labor cost by statistics, and as I recall between 1947 and 1959, according to the Bureau of Labor Statistics figures, for the American private economy as a whole you had an increase in the costof labor per hour of 102 percent.

Senator PROXMIRE. What were the years?

Mr. HAGEDORN. From 1947 to 1959. You had an increase in the cost of labor per hour of 102 percent.

Now, a part of that, of course, was offset by increases in productivity, but not all of it was, and the net result was that the increase in unit labor cost over that same period was 37 percent.

Senator PROXMIRE. Could I ask for clarification there? When you say labor cost between 1947 and 1959, you are talking about wages or wages per hour, or are you talking about it being corrected for productivity increases, and so on?

Mr. HAGEDORN. I said there was an increase of 102 percent in the cost of labor per hour. Some part of that was offset by increases in productivity.

Senator PROXMIRE. Often when people say the cost of labor, they are talking about a cost that has been corrected for productivity increases and you apparently are not.

Mr. HAGEDORN. That figure of 102 percent is not, but when you correct if for the increases in productivity then you come to the figure of 37 percent. That is the increase in unit labor costs, the amount of labor cost embodied per unit of output.

Have I made the distinction clear, Senator?

Senator PROXMIRE. I don't want to keep interrupting because I know that the chairman is following the policy of presenting it without questions, but since you asked me, the thing that I have in mind is this: I have been amazed at the fact that in some periods during the time you are talking about that actual drop which has been stipulated to by management as well as labor and which has been enunciated as I understand it by Government economists, a drop in labor costs, at the time that wages were rising, and a very substantial drop in labor cost.

This usually takes place when you are moving from a recession to a prosperous period and you are utilizing your available resources more efficiently and more productively.

Therefore, I think it is extremely important that we not fall into the trap of assuming that because wages have increased so sharply there is necessarily anything like as sharp an increase in labor costs.

I think labor costs are by all odds the most important consideration in the argument that you are making.

Mr. HAGEDORN. Yes, it is, Senator.

The CHAIRMAN. We did not anticipate this meeting going so long, and so we had other arrangements made for 5:15 for this room. That is only 5 more minutes. I regret that exceedingly. We can give you another time if you want to come back.

Mr. HAGEDORN. May I go on with my discussion, and I will try to make it very, very brief.

The CHAIRMAN. All right.

Mr. HAGEDORN. I will try to make my major points in 5 minutes.

The CHAIRMAN. You have your statement in the record, anyway.

Mr. HAGEDORN. Yes, and since I have so brief a time, let me skip over some of the things I would have liked to have said, and emphasize the fact that in all of the discussion here this afternoon I don't recall hearing the concept of profits mentioned. It might have been mentioned as a possible result of what happens in our economy, but we keep forgetting that profit is the driving force of our economy. It is the cause of people undertaking business ventures.

I take back my earlier statement, for I believe Dr. Schmidt did mention the expectation of profit as an important driving force. But, of course, the expectation of profit is closely related to the actual current experience on profit.

I would like to call your attention to a table on profits which appears in my statement. This covers the period 1947 through 1960, and the figures are taken from the President's Economic Report.

Between 1947 and 1960, you had more than a doubling of the gross national product, and most of the other dollar magnitudes which are used to measure the performance of the whole economy. On the other hand, look at profits. Profits before taxes increased not 100 percent but only about 50 percent, from $29.5 to $45 billion. Profits after taxes increased only about 25 percent, while everything else in the economy more than doubled. It is also interesting to notice that over a 10-year period, taking 1950 and comparing it with 1960, there was no similar growth in profits before taxes and almost exactly the same figure for the 2 years in profits after taxes. It was $22.8 billion in 1950, and $23 billion in 1960.

There has been something radically wrong with this fundamental driving force in our economy. And here, too, it has been labor costs largely squeezing on the profitability of business operations.

In the course of this profit squeeze, many marginal operations that might otherwise have been profitable and might have been initiated, just aren't worth undertaking, and the people who might have been employed in those marginal operations do not get employed.

Another question which is implied in this development of thought, is, Why is the unemployment problem suddenly developing now, if we have had this upward trend in labor costs for the past 15 years? Why didn't it result in catastrophe before this? We can point out that we have been protected against such a catastrophe by a combination of circumstances occurring in earlier years. Immediately following the war period, we had an accumulation of purchasing power, an accumulation of needs which promoted high levels of business, and then we had the Korean war which again provided a stimulus to the economy, offsetting the depressing effects of increases in the level of costs. Furthermore throughout that period, and in fact until about 3 years ago we were insulated against foreign competition with our products.

The other industrial nations of the world weren't producing a surplus, as their economies hadn't sufficiently recovered to the point where they had a surplus for export, and could compete with our goods.

The CHAIRMAN. We appreciate your coming here and giving us your statement. We are looking forward to reading your fuller statement in the record. I regret that your time has not been at a better hour; next time we will try to schedule you at a time when there will be no question about the hour. We thank you very much, sir. You may extend your remarks to include anything that is germane to the statement you have made.

Mr. HAGEDORN. Thank you very much, Congressman.

The CHAIRMAN. Tomorrow we meet in the New Senate Office Building, that is, in the auditorium, at 10 o'clock tomorrow morning. We will have a panel discussion of three farm groups; we will have the CED, and the Federal Statistics Users' Conference. That is at 10 o'clock in the auditorium in the New Senate Office Building tomorrow morning.

Thank you; we appreciate the witnesses coming here.

Mr. HAGEDORN. Thank you, Congressman.

The CHAIRMAN. Without objection, we will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 5:15 p.m. the committee was recessed, to reconvene at 10 a.m. Friday, February 10, 1961.)

JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

FRIDAY, FEBRUARY 10, 1961

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

The committee met, at 10 a.m., pursuant to recess, in the auditorium, New Senate Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Griffiths, and Kilburn; Senators Douglas, Sparkman, Proxmire, and Bush.

Also present: John W. Lehman, clerk and acting executive director.

The CHAIRMAN. The committee will please come to order.

This morning we complete the portion of our hearings devoted to hearing from group representatives.

As I explained yesterday, the discussions will include comments both on the Economic Report submitted by President Eisenhower, and the economic messages sent to the Congress by President Kennedy.

We will first hear from Mr. Stein.

We will hear from the panel representatives of the farm organizations after we hear from Mr. Stein.

Mr. Stein, you have a prepared statement, do you not?

Mr. STEIN. Yes; I do.

The CHAIRMAN. You may proceed in your own way, sir.

STATEMENT OF HERBERT STEIN, DIRECTOR OF RESEARCH, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. STEIN. Thank you, Mr. Chairman, for taking me out of order so that I may catch a plane.

I want to thank you for your invitation addressed to the Committee for Economic Development to participate in these hearings. I should say that while I shall refer here to some CED experience I do not speak on behalf of CED, which speaks only through its duly constituted committees.

If we look at what people do, as well as what they say, we can see the emergence of a remarkable consensus in this country about policy to maintain high employment and economic stability. The main ingredients of the consensus, in my opinion, are these:

1. The automatic variation in the budget position from surplus in prosperity to deficit in recession is a good thing. It tends to stabilize the economy and we should not interfere with it. The acceptance of the big budget deficit in 1958–59 illustrates the consensus on this point.

2. Strong budgetary measures to stimulate the economy, beyond the deficit that automatically results from a recession, should be reserved as a second line of defense for unusually serious situations.

3. When strong budgetary stimulus is required, tax reduction, rather than expenditure increase, is the best course available.

4. Flexible monetary policy—implying higher interest rates in prosperity and lower rates in recession—has an important role in economic stabilization. There are still people who regard themselves as tight-money men or easy-money men, but very few, I think, who believe that money should be equally easy or equally tight all the time.

5. Fiscal and monetary policy operate upon an uncertain future. This calls for—

(*a*) Caution and flexibility in action; and

(*b*) Charity in judging the mistakes of others after the fact.

6. The timing and force of measures to achieve high employment will have to be moderated because of the general interest in avoiding inflation and safeguarding the balance of payments. This is an additional strong reason to make sure that those individuals who bear the brunt of unemployment are adequately covered by unemployment compensation.

7. Some categories of unemployment, including unemployment concentrated in particular areas, will not yield to general fiscal and monetary policy. Special measures will be needed, although it should be admitted that we know little about the measures that are likely to be effective.

This consensus is not the end of wisdom. There is still much to learn. But still it is a great achievement. The gap between public policy and the thinking of responsible public officials, on the one hand, and the thinking of economists, on the other hand, has become quite small.

To narrow this gap was, I take it, one of the chief objectives of the Employment Act of 1946.

The members of the Joint Economic Committee and of the Council of Economic Advisers, Republicans and Democrats alike, can take pride in the degree to which this objective has been achieved.

May I say that we in the Committee for Economic Development also take some pride in it, because the present consensus is very close to the doctrine that CED has been developing and preaching.

It is sincerely to be hoped that the existing consensus will not be weakened by partisanship. There is a tendency for both Republicans and Democrats to deny that Republicans have ever learned anything, and for both Democrats and Republicans to deny that Democrats have ever learned anything. But the fact is that both have learned a great deal since 1930 or 1950. Denial of this fact perpetuates unreal argument, impedes effective action based on the real consensus, and slows down progress toward the solution of the real unsolved problems.

The number of points that the existing consensus does not solve is large. In the limited time available to me I shall concentrate on two points, both of long-run importance as well as relevance to the immediate situation. Both points indicate the need for much more precision and sophistication in making budget policy.

It should come as no surprise to this committee to be told that the tax rates and expenditure programs enacted by Congress do not, by themselves, determine what the Federal budget surplus or deficit will be. They only create a certain relationship between the surplus or deficit and economic conditions.

No one can look at the tax rates and expenditure programs and say that the surplus will be, say, $2 billion.

He can only say that the surplus will be $2 billion if unemployment is X percent, the surplus will be some larger amount if unemployment is less than X percent, and some smaller number, or a deficit, if unemployment is more than X percent.

The table below shows the Federal surplus or deficit in each of the calendar years 1955–57, and half years 1956–60, alongside the contemporary unemployment rates.

The half-year surplus or deficit figures are annual rates, seasonally adjusted.

The surplus and deficit figures are from the national income accounts because for a variety of reasons these figures give a better picture of the simultaneous relation between Federal receipts and expenditures and economic conditions than does either the conventional or the cash budget.[1]

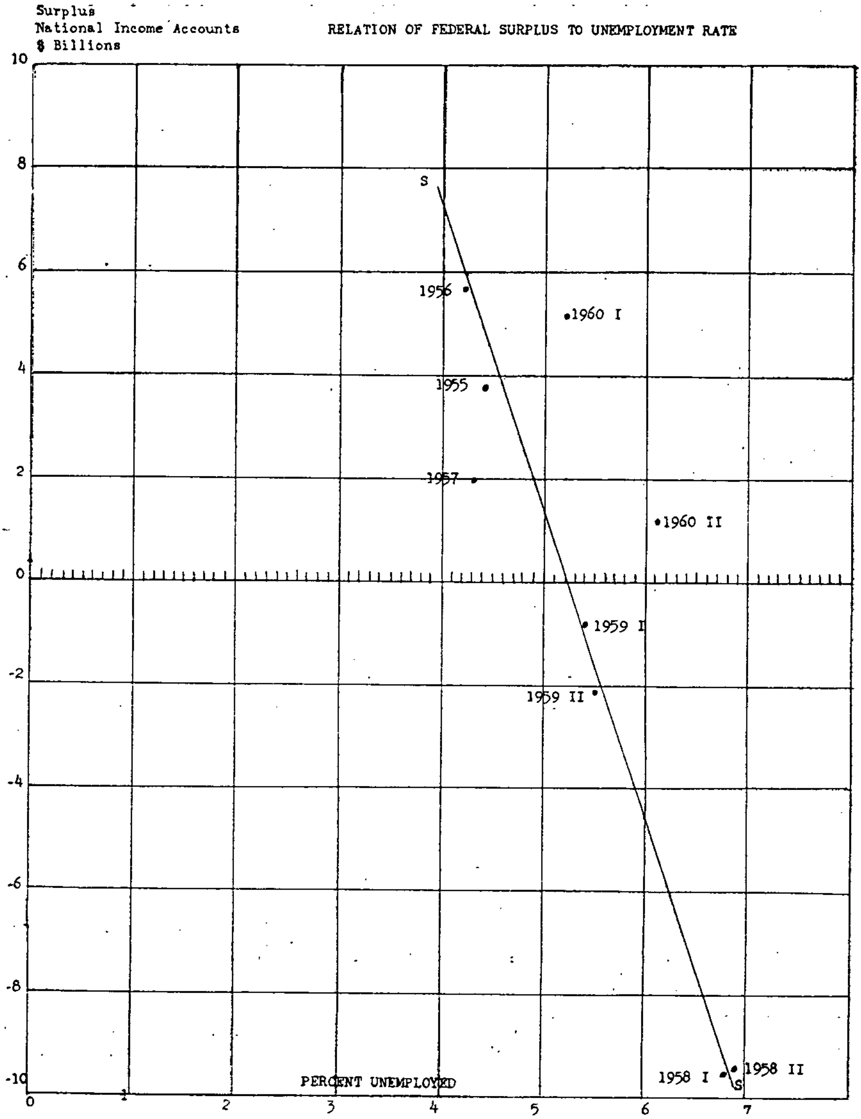
Period	Federal surplus in billions	Percent unemployed
Calendar year:		
1955	$2.8	4.4
1956	5.7	4.2
1957	2.0	4.3
1958, 1st half	−9.5	6.8
1958, 2d half	−9.4	6.9
1959, 1st half	−.8	5.4
1959, 2d half	−2.1	5.5
1960, 1st half	5.2	.2
1960, 2d half	1.2	6.1

These numbers are plotted on the accompanying chart, which shows the percent unemployed on the horizontal axis and the surplus or deficit on the vertical axis.

One striking fact that emerges from this chart is that from 1955 through 1959 all the points lie close to a straight line which is drawn in and labeled "SS."

[1] A reconciliation of the national income account figures and the conventional and cash budgets may be found in the Economic Report of the President, January 1961, p. 190.

(The chart referred to follows:)



Mr. STEIN. This suggests that throughout this period we had a relationship between tax rates and expenditures that balanced the budget when unemployment was 5.2 percent.

This relationship gave a surplus of about $6 billion for each 1 percent by which unemployment was under 5.2 percent, or a deficit of $6 billion for each 1 percent by which unemployment exceeded 5.2 percent.

In the first half of 1960 we moved to a surplus far greater than would have been yielded by this 1955–59 relationship. With 5.2 percent unemployed, we had a surplus at an annual rate of $5.2 billion, instead of an even balance as the previous relationship would have given.

In the second half of 1960 we remained far above the previous relationship, getting a surplus of $1.2 billion with 6.1 percent unemployed.

I believe that the weight of the 1960 relationship between surplus and unemployment contributed to stopping the recovery that was underway in 1959. Some budget surplus under conditions of high employment is a good thing, but obviously there are limits. We can have too much of a good thing.

In this connection there are three things to be said:

1. It may be possible to have high employment with a budget that yields a surplus in excess of $5 billion when unemployment is as high as 5 percent, but this is by no means certain.

2. Even if we can adjust, in the long run, to living with so large a budget surplus, a change as sharp as the one between the second half of 1959 and the first half of 1960 is likely to cause trouble.

3. The attempt to achieve high employment in the face of a budget that would yield very large surpluses at high employment requires rapid monetary expansion to offset the depressing effect of the budget. This means low interest rates, and, unless other countries are following a similar policy, this is likely to cause an outflow of capital and balance-of-payments difficulties.

In fact, during 1960 we did get an easing of monetary policy. This was not sufficient to maintain high employment, but it did contribute to the decline of U.S. interest rates, to the outflow of short-term capital and to the balance-of-payments deficit.

I think a mistake was made in budget policy in 1960. This, however, is not my main point.

My main point is that this error crept up on us unawares. I don't know anyone, in or out of Government, who is in a position to say, "I told you so." I don't know anyone who realized before the summer of 1960 how big a surplus we would be running if we had high employment.

This is what concerns me, because it means that we are not well equipped to prevent a recurrence of such an error or to detect it promptly.

We have not been identifying with sufficient preciesion either where the budget actually stands or where we would like it to stand. I suppose it is by now accepted doctrine that the budget should yield a moderate surplus under conditions of high employment. A budget that would yield a surplus of $3 billion when unemployment is 3 percent, might be considered to meet this standard and so might a budget that would yield a surplus of $6 billion when unemployment is 5 percent. But these two budgets would be enormously different in their economic effects.

In my opinion, we need two things:

First, we need more precise information about the size of the surplus or deficit that the existing or proposed tax system and expenditure programs would yield under different economic conditions. The Budget Bureau can provide us with this information.

Second, we need to develop our standards of budget policy beyond the rather vague concepts of balancing at high employment or balancing over the cycle.

I have been talking up to this point about the normal relation between the budget and the level of employment or economic activity, the relation that we expect to prevail when the economic situation does not call for extraordinary measures.

I shall now turn briefly to the problem of extraordinary measures, specifically to the one most commonly discussed; namely, a temporary tax cut to stimulate recovery from recession. This is a powerful instrument, potentially useful and also potentially dangerous. We need to be prepared to use this instrument, and this requires us to find ways to make its use safer.

The problem of making a tax cut safely can be illustrated by recalling the experience of 1958. In March 1958, when the economic statistics for February were available, the Program Committee of CED issued a statement recommending that if the economic decline should continue for 2 more months—through March and April—a temporary tax cut should be enacted.

The Committee calculated that 2 more months of the decline would bring the unemployment rate to about 7¼ percent.

The statement suggested that if a tax cut were made, it should expire automatically on March 31, 1959, at which time Congress would be in session and could extend the tax cut if it wished.

In fact, the economy did decline in March and April, but began in May, what was for some time a quite vigorous revival. We were at the margin of the conditions that, under CED's recommendations, called for a tax cut.

Some of you may remember that on or about April 30, 1958, this Joint Economic Committee held hearings at which several experts testified on the economic situation and what to do about it. Opinions were varied, but no one knew that at the time of the hearings the recession had come to an end and recovery was beginning.

Suppose that events had been a little different, and Congress had cut taxes in 1958. Would that have been a good thing?

I do not ask this as a rhetorical question to which the answer is obviously no.

Even with the benefit of hindsight it is by no means clear that we would be worse off today if we had cut taxes in 1958.

Still an attempt to reconstruct history since 1958 on the assumption that taxes had been cut then will reveal a number of dangers. These include the danger of intensified inflation, the danger of a subsequent sharp decline, resulting either from the inflation itself, or from the sudden expiration of the tax cut, the danger that what was intended as a temporary tax cut would have become permanent, foreclosing the possibility of more desirable longrun tax reform and imposing an excessively low ceiling on important expenditures.

The dangers of using a tax cut as an antirecession instrument result in part from limitations on our ability to foresee the economic future. These limitations will be reduced slowly and partially, if at all.

But the dangers result in part also from attitudes and practices of the Government, including the Congress. Congress does not distinguish clearly between temporary, antirecession tax changes and tax changes intended to be permanent.

As a result, the decision to make a tax cut is much more difficult and time consuming than it need be.

The same lack of distinction would interfere with the restoration of the cut taxes when the economic situation calls for it.

Moreover, Congress dislikes to raise taxes at any time. It has a tendency to cut, or expand, the coat of expenditures to the cloth of taxes, rather than freely considering a mutual adjustment between taxes and expenditures.

Congress especially dislikes to raise some taxes while cutting others, so that any temporary tax cut is a strong rival to possible permanent tax reform.

Most of these problems are aspects of one problem.

Congress, like almost all the rest of us, dislikes higher taxes.

But to make the world safer for antirecession tax cuts we need to increase the willingness to raise taxes, in appropriate circumstances and forms.

To improve congressional understanding of this point is, I believe, an important function of this committee.

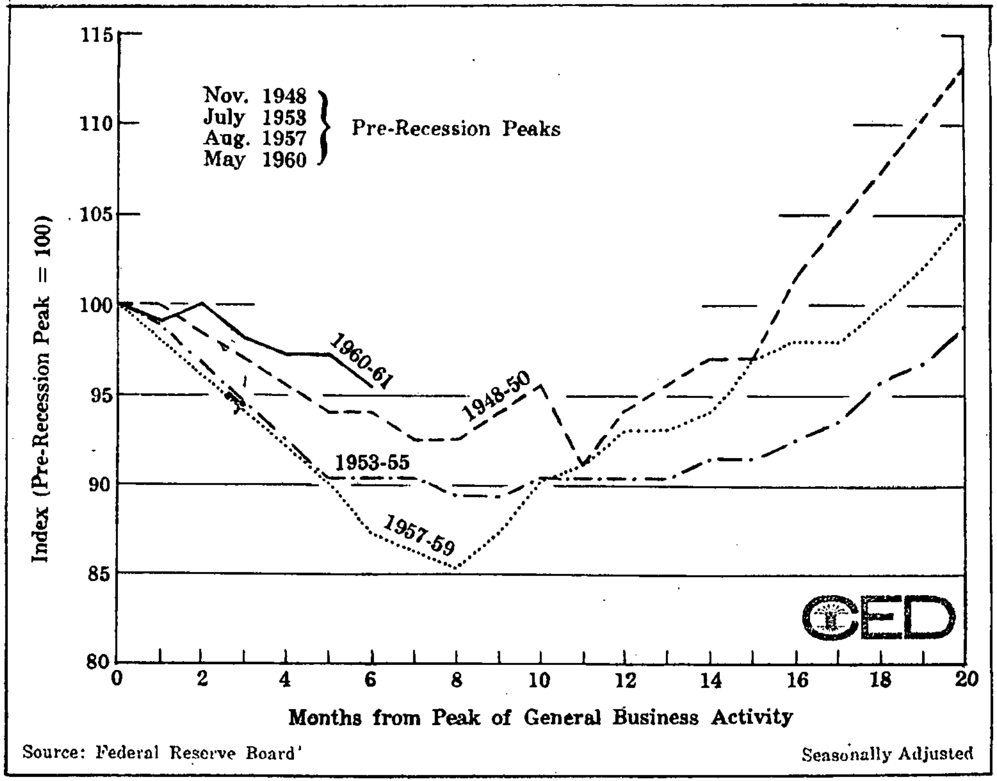
Now, I have appended to my statement two charts prepared in another connection, but which I believe the committee may find of interest. They describe the conditions of the last few months as compared with conditions in similar phases of the other three postwar recessions.

What they reveal is fairly well known, that in the current movement, 1960–61, we have at the same stage, which is 7 months after the previous peak of business activity, a somewhat higher rate of unemployment than we had in the first two postwar recessions, but somewhat less than in the 1957–59 recession.

The CHAIRMAN. These charts will be inserted in the record.

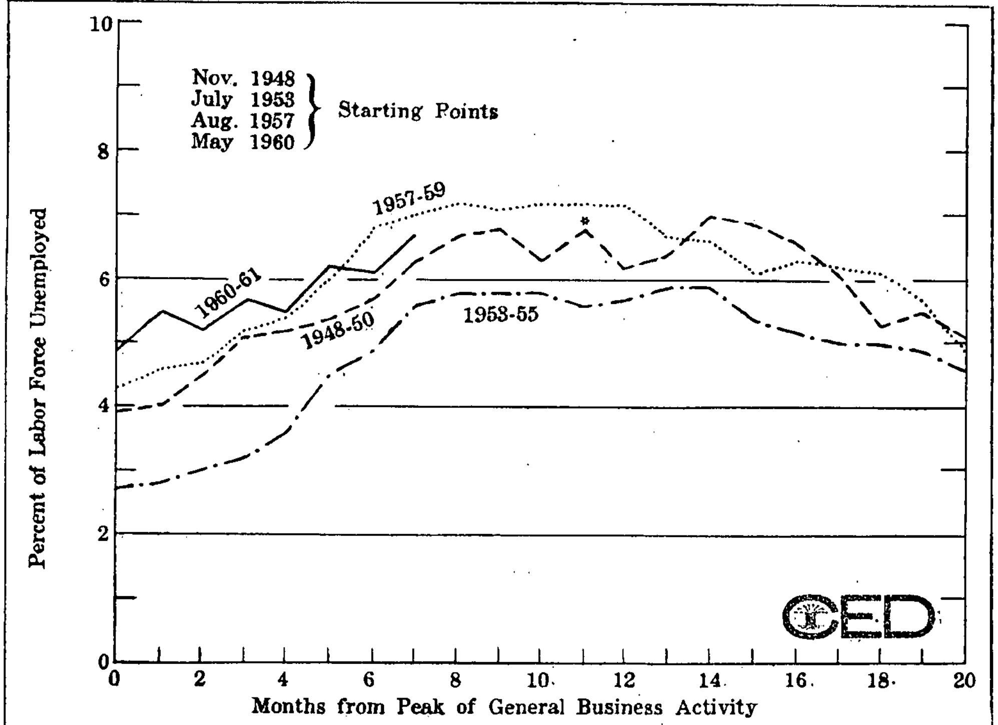
(The charts submitted by Mr. Stein, accompanying his formal statement, are as follows:)

INDUSTRIAL PRODUCTION



UNEMPLOYMENT

As a Percent of Labor Force



* Reflects secondary effects of major strikes

Source: Dept. of Labor

Seasonally Adjusted

66841—61——15

Mr. STEIN. If I may comment for one moment on the industrial production chart——

Senator BUSH. On the industrial production chart you do not have unemployment?

Mr. STEIN. I have two charts, one is unemployment and one is industrial production.

The industrial production chart shows that the decline so far has been smaller than any of the three previous recessions, but I suppose larger than anything we have not called a recession.

That concludes my statement.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. First, I would like to tell you, Mr. Stein, I think this is an extremely intelligent and very, very helpful presentation. I think it certainly helps my understanding of the situation.

I think the suggestions you make are very useful.

I would like to ask you a couple of brief questions.

You seem to assume that any kind of budget deficit, at least, I take it from what you have said, any kind of budget deficit is likely to have an expansive effect on the economy and any kind of budget surplus is likely to have contracting effect.

I wonder if we should have a much more qualitative analysis. I can imagine a situation in which you would have a budget surplus, but because of an adequate social security program, unemployment compensation program, and so forth, because of monetary policy which stimulates construction, you might have an economy that would expand as a result of governmental policy with a small surplus, moderate surplus.

Mr. STEIN. I would certainly agree that the total combination of governmental policies might be expansive even though the budget was running a surplus.

The point I am really making is that I think a bigger budget surplus is more repressive than a smaller budget surplus and, therefore, in conditions when the economy is weak, will require more offsetting, and possibly if the difference between the two budgets is very big, more offsetting than we are likely to be able to produce from other sources.

I should also say that the budget as I look at it, the budget charted here, or the cash budget, would include the effect of the social security program, so I think one would have to conceive of a very extreme and unlikely change in the internal composition of the budget to postulate a situation in which a budget with a surplus is more expansive than a budget with a deficit.

Senator PROXMIRE. Yesterday we had Walter Reuther of the AFL–CIO, who proposed a temporary tax cut for 10 weeks of $10 per person.

I felt, I had no chance to express it then, but I felt that this might not have much of a stimulating effect on the economy, especially if it is only for 10 weeks, this is a temporary tax cut.

People know that their taxes are going up again; they are going to be increased after 10 weeks under the proposal of Mr. Reuther.

At the same time, if you do not have that and you accept the Reuther analysis and the analysis of many economists, that much of the unemployment is likely to be permanent, if you expect the President and the Congress to keep extending this, then you are going to get yourselves into very great fiscal difficulties and it seems to me you are adopting a policy that could be fiscally irresponsible.

You are trying to solve a long-range unemployment situation by not having adequate revenues, a permanently unbalanced budget.

It would seem to me that this is something that the Congress cannot responsibly go into especially with the dangers you so persuasively set forth at the conclusion of your statement.

Mr. STEIN. I agree this is not the time for temporary tax cut. I think that is the position that the President has taken.

The point that I was trying to illustrate with my chart, which I recognize is rather complicated——

Senator PROXMIRE. I do not want to interrupt you, but I did go on in my statement, the main gist of my question, the main point of it was directed to the psychological effect of a tax cut as compared with President Kennedy's suggestion that social security be increased $10, especially in the low brackets. This would be spent at once. A temporary tax cut might not be spent at all. It might be hoarded to a very great extent.

Mr. STEIN. It might be, and there is some argument about that among the economists.

The evidence is not quite conclusive, but it is my opinion that by and large the money that is paid out will be spent.

Of course, $10 for 10 weeks is only $100. It is not as much as $10 for 50 weeks, but I think it has some stimulating effect, not dollar per dollar, but to a large extent.

The social security thing is obviously a commitment which lasts for a long time. It seems to me that this decision about social security ought to be made in terms of what we regard as the proper permanent character of the system and within the limits of the actuarial possibilities of the system assuming we are going to confine ourselves to the kind of social security theory that we have had. It is not, therefore, very available as an antirecession measure.

It is not a thing you can turn off again once you have done it.

Senator PROXMIRE. I will conclude my questioning by saying my own philosophy is you cannot predict the recessions anyway. The best thing you can do is to provide the strongest possible automatic stabilizers and then try to be responsible in balancing your budget.

This is a personal conviction I have come to in recent years on the basis of my own observations. It does not contradict what you have said.

Mr. STEIN. I don't feel it contradicts what I have said. I would agree with you.

I am trying to pinpoint a little more what balancing the budget means.

Do you mean to have a budget that balances at 4 percent unemployment, or a budget that balances at 5 percent? You won't have a budget that balances at all levels of unemployment.

You have to make a choice about this. That is the choice I am trying to highlight in the middle part of my testimony.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bush.

Senator BUSH. Do I take it that you think there is some sort of rigid relationship between a budget surplus or deficit and unemployment, these things are geared together?

Or do these figures just happen to fall together?

I have been under the impression that they rather fall together and that one does not predetermine the other, so to speak.

I am a little surprised that in your presentation you seem to feel that you can almost say in advance that if we are going to have a $2 billion surplus that the unemployment factor will be so-and-so.

Mr. STEIN. No, I say it the other way around. Given the tax rates which are on the books and the expenditures programs that are on the books, that if you will say how much unemployment is going to be, you can predict more or less what the surplus will be, or deficit.

The surplus or deficit will depend on the state of the national economy.

Once you have passed a tax law, the tax revenue depends on the state of the economy. You get much more tax revenue from $50 billion of corporate profits than from $30 billion.

You will get much more personal tax if the personal income is $350 billion than you will if it is $300 billion.

There are a lot of variables involved here.

In a general way there is a relationship. I am saying that in the period from 1955 through 1959 this relationship remained rather constant. We had no major change in the tax law. There was a general tendency for expenditure to rise as the yield from the tax system grew with the growth in the national economy.

I think in 1960 we got away from this relationship, partly because the growth of the expenditures was slowed down and partly because we did get some additional revenue from revisions in the Social Security Act.

Senator BUSH. In your closing paragraph you speak, you say:

> To make the world safer for antirecession tax cuts we need to increase the willingness to raise taxes in appropriate circumstances and forms.

What do you have in mind there as being appropriate circumstances and forms? Are you thinking in terms of a sales tax of some kind?

Mr. STEIN. I think the appropriateness of the sales tax would depend on the conditions.

What I really have in mind is that having cut taxes in order to stimulate the economy we must be prepared to raise taxes again when it is appropriate in order to prevent inflation or if there is a substantial increase in the expenditure programs of the Government.

I think what people are concerned about, and I think this is a concern that President Kennedy expressed in his press conference, is that if we do make a temporary tax cut to combat a recession it will be very difficult to get this undone if the economy should start booming and it will be very difficult to get taxes raised in order to match some increasing expenditures if the international situation or something else should make an increase in expenditures very important.

So that we would then operate, as we tend to do, within the straitjacket of whatever tax system we happen to have.

I think it would be rare to find a case where Congress had significantly raised taxes except in wartime and we seem not to have this instrument available to us.

Senator BUSH. I have just one more thing, Mr. Chairman. I notice Mr. Stein says:

We need two things: first, we need more precise information about the size of the surplus or deficit that the existing or proposed tax system and the expenditure programs would yield under different economic conditions. The Budget Bureau can provide us with this information.

What use do you think we would make of that information, Mr. Stein?

Mr. STEIN. Well, this would enable you to tell whether you were changing the degree of repression or stimulus that you get from the budget from year to year.

For example, we have a budget message which forecasts we are going to have a surplus of $1 billion in 1962 and surplus of $1 billion in 1961.

Are these surpluses of the same degree of repressive effect on the economy, or is one more repressive or stimulating than another?

Well, this certainly depends on whether the surpluses in the 2 years are to be achieved at the same levels of economic activity.

A surplus of a billion dollars that is to be achieved with 5 percent unemployment is much more repressive than a surplus of a billion dollars to be achieved at 4 percent unemployment.

So that I think we would have a clearer idea of which way the budget was moving, whether in a repressive or expansive direction.

Senator BUSH. In the middle of page 7 you speak of a tax cut being a powerful instrument. We need to be prepared to use this instrument and make its use safer.

You say it is potentially useful and potentially dangerous.

What experience have we had that would suggest that the use of the tax cut is such a powerful instrument? What historical references can you give the committee on that?

Mr. STEIN. I think that the conclusion does not derive from historical examples of the use of tax cuts specifically as an antirecession instrument. It is derived basically from the long observation that consumers expenditures are very closely related, although not without some variation, but very closely related to the income that consumers have available after taxes.

Therefore, if this is correct, then reducing taxes will increase the income that consumers have available after tax and will increase expenditures.

Senator BUSH. We have never used the instrument in my lifetime, I do not recall that we have.

I am asking you whether we have?

Mr. STEIN. No, we have not.

Senator BUSH. In other words, this is a new idea?

Mr. STEIN. Well, it is not a new idea.

Senator BUSH. Well, as far as using it is concerned?

Mr. STEIN. It has not been used. The idea has been discussed a good deal.

Senator BUSH. There is some difference of opinion about what would be done with the money under a tax cut. In the first place, the people who got the money would be mostly people who were employed, I mean who got the benefit of the cut, because it was their income tax that would be cut.

What would they do with the money? Well, these people, it is thought, would not necessarily be rushing out to spend that money. A lot of them would put it in the savings bank and otherwise withhold it from immediate expenditure.

I think this raises some doubt as to the efficacy of this so-called powerful weapon.

In other words, it does not shock me to think of the possibility of tax cut. I would only want to do it on the assurance that I thought it would really put money to work.

We do not have very much evidence before this committee or the Banking and Currency Committee. We had hearings on the subject there, related subject.

I do not think that the proponents of tax cut have made a very good case for it, either, by experience or showing what would happen to the money.

You are not necessarily a proponent of it, either.

Mr. STEIN. Well, I am a proponent of it in certain circumstances. I am not a proponent of it at this hour. I don't think it is necessary to prove that every dollar of it would be spent in order to prove that it would be effective.

The main thing attractive about a tax cut is that you have so much money to work with. After all, we have a lot of taxes to cut. If you would assume that only 50 percent of it would be spent, you can get a very big stimulus.

You can get a stimulus of $5 billion by this route, assuming 50 percent of it would be spent, much faster than you would get a stimulus of $5 billion by increasing Government expenditures.

You can cut $10 billion out of the tax system very quickly.

Senator BUSH. I just observe, Mr. Chairman, that I think there has been a much better case made for putting money in the pockets of the unemployed under current conditions or similar conditions than for a tax cut which would put money in the pockets of the employed.

Mr. STEIN. I don't disagree with that at all, but the numbers involved are quite different, I think. A program such as the extension of unemployment compensation for another 13 weeks will put some money into the hands of 2 million people who will undoubtedly spend it very rapidly, but I think the total amount of money you can put in their hands is small compared with the amount of money you can put in the hands of 60 million taxpayers.

That is why I think it is much better, but it should be reserved for more serious situations.

Senator BUSH. I am sure we agree if we could make a tax cut that would benefit the employed and still produce a budget surplus we would be in favor of that, but that does not seem to be an imminent possibility.

Mr. STEIN. Well, I don't think we want a budget surplus when we have large unemployment.

Senator BUSH. No; I did not suggest that we did. I suggested that at a time when we get a budget surplus that is the time to consider, in my judgment, a tax reduction that would be beneficial to those that are employed and producing the income.

Mr. STEIN. Yes.

Senator BUSH. Thank you, Mr. Chairman.

The CHAIRMAN. Mrs. Griffiths.

Representative GRIFFITHS. In the first place, I would like to say that I think you have made a very interesting analysis. I have enjoyed it.

I would like to ask you on this matter of unemployment compensation, do you feel that this Congress would be justified now in making available to the States additional funds by which they could extend the coverage of unemployment compensation or increase the amount, or both?

Mr. STEIN. I take it you are talking about something other than the temporary extension of benefits up to a 13-week period.

Representative GRIFFITHS. Would you think this would be advisable now?

Mr. STEIN. Yes.

Representative GRIFFITHS. Do you think it would be advisable to make a permanent extension or not?

Mr. STEIN. I really would not be prepared to say that and I would not recommend it at this time without more careful consideration of the State-Federal relations in this area.

I think that there are aspects of the system, particularly with relation to the benefit rate rather than to the duration, which more properly belong within the purview of the States.

In general, this is a State finance system. I don't think it is necessary to make this decision within the context of the present recession.

The question of the area to which parts of the program to which Federal standards may appropriately apply and the part to which Federal standards may not, is a difficult one.

I think some line needs to be drawn there, but I am not, myself, sure where it ought to be.

Representative GRIFFITHS. Thank you very much.

I would like to say in regard to your last remark on your written statement that while I think Congress might have a fairly good understanding of tax cuts and tax increases, I think the problem is that they worry about their constituents' attitudes on tax cuts and tax increases.

We need more congressional constituent understanding.

Mr. STEIN. That is an education problem on which this committee and our committee work.

Representative GRIFFITHS. Thank you.

The CHAIRMAN. Mr. Kilburn?

Representative KILBURN. I am sorry I missed the first part of your statement.

I have no questions at this time.

The CHAIRMAN. I want to ask you only one question.

Do you have any proposal as to how tax cuts and tax increases could be made automatic?

Mr. STEIN. I don't think that economists know enough about the determinants of economic activity and signals which might forecast economic activity to be able to specify a formula under which this might be done. So I would not think it feasible to specify an automatic formula by which this could be done.

I think one might specify criteria which have to be looked at.

For the time being, I think that is as far as we could go.

I would hope we could learn more about this, but I think it would be a little dangerous. I think efforts have been made retrospectively to figure out what would have happened if certain formulas had been applied and it never looked very satisfactory.

The CHAIRMAN. Let me suggest a proposal for your consideration.

As you know, much is being said about Congres appropriating more than we have the money to pay for.

What would you think about a law which would give the President of the United States discretionary power to raise taxes, on incomes up to a limited amount, say, 10 percent, to balance that budget in good time, when Congress adjourns without balancing its budget? And in the event of a recession, the President would have the power to reduce taxes by as much as, say 10 percent?

Does that impress you as meriting consideration?

Mr. STEIN. Well, I think it has merit for consideration.

The CHAIRMAN. I will not press you on this because we have the farm people here, and we were to hear from them this morning, and of course the hour is growing late.

Senator PROXMIRE. I would like to ask one question if I may.

I was very much interested in the suggestion of the chairman that the tax cut might be made automatic. This would solve a lot of the dangers you have in regard to the Congress not being willing to initiate a tax cut that might become permanent and the President being hesitant to do it.

Now, in your answer it seems to me that you raise another question. You said to Senator Bush that you felt the Budget Bureau could indicate whether a surplus would be repressive on the basis of their own estimates of what the unemployment situation was going to be.

In other words, if they estimate an unemployment situation during the budget year, which is about at least a year and a half in advance, of 5 percent, then the repressive effect would be much greater than if it were 4 percent.

Then you told the chairman of the committee that you had great hesitation about the state of the science of economics that they would be able to give criteria for making automatic tax cuts.

Do you not have hesitation about the state of economic science being able to forecast that much in advance what the unemployment situation is going to be.

Mr. STEIN. I have not made myself clear. I don't want the Budget Bureau to tell us that in the next fiscal year unemployment will be 5 percent and the surplus will be x billion. What I want them to tell us is if unemployment is 5 percent, the surplus will be x percent.

If unemployment is 6 percent, it will be y. If it is 7 percent, it will be z. If it is 4 percent it will be some other number.

Senator PROXMIRE. Then the Congress has to make the estimate?

Mr. STEIN. I don't think you should be involved in estimating what the surplus will be. I think you want to know what line you are operating on in terms of the chart I have drawn here.

Are you operating on a line which would give you a balance at 5 percent? Are you operating on a line which would give you a balance at 4 percent? Are you operating on a line which would give you a balance at 6 percent?

I think it is a little bit like asking what is the temperature at which water boils.

Well, this depends on the height above sea level. You say are we going to have a budget surplus at what point?

This depends on the economic level.

Senator PROXMIRE. Thank you.

The CHAIRMAN. Without objection, I will insert in the record at this point a bill I have prepared to carry out the suggestion I made about giving the President the power to raise taxes in good times by as much as 10 percent on individual and corporate incomes, and to cut taxes by as much as 10 percent, from the statutory levels, in the event times are bad and a tax cut is needed as a stimulant to the economy.

I will put that in the record at this point.

(The material referred to follows:)

[H.R. 12360, 86th Cong., 2d sess.]

A BILL To provide for increases and decreases in income tax if the President determines and proclaims that economic conditions require such increases or decreases

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DECLARATION OF POLICY.

In order to keep the debt of the United States at the lowest level consistent with the provision of an adequate national defense and a reasonably sufficient civilian Government, and to make reductions in the debt of the United States in periods of prosperity, the public policy of the United States shall be to make temporary increases in the rates of Federal taxes as an alternative to, and a substitute for, any policy of the Federal Government to impose high interest rates on the economy as a means of curbing economic expansion or restraining inflation.

SEC. 2. ADJUSTMENT OF INCOME TAX RATES.

Subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to determination of tax liability) is amended by adding at the end thereof the following new part:

"PART V—ADJUSTMENT OF RATES OF TAX TO REFLECT ECONOMIC CONDITIONS

"SEC. 51. INCREASE OR DECREASE IN TAX.

"(a) PROCLAMATION BY PRESIDENT.—

"(1) DETERMINATION THAT INCREASE IS REQUIRED.—If, during any year, the President determines that an increase in income taxes is necessary to balance the national budget and to provide for a decrease in the public debt and that economic conditions are such that an increase in such taxes is in the national interest, he shall proclaim such determination and the percentage increase in tax which he determines is necessary or desirable by reason of such conditions.

"(2) DETERMINATION THAT DECREASE IS REQUIRED.—If, during any calendar year, the President determines that a decrease in income taxes is necessary to prevent, or to assist in preventing or counteracting, an economic depression or recession, he shall proclaim such determination and the percentage decrease in tax which he determines is necessary or desirable for such purpose.

"(b) INCREASE OR DECREASE IN TAX.—

"(1) IN GENERAL.—If a proclamation is made under this subsection, then (subject to the provisions of this part) the tax imposed by this chapter (other than subchapter G, relating to additional taxes in cases of corporations used to avoid income tax on shareholders) for the taxable year during which such proclamation is made is hereby increased or decreased, as the case may be, by the percentage determined and proclaimed by the President.

"(2) LIMITATION.—The increase or decrease in tax for any taxable year under this subpart shall not exceed an amount equal to 10 percent of such tax as computed without regard to this subpart.

"(3) APPLICATION OF CHANGE.—Any increase or decrease in tax under this subpart shall apply only with respect to taxable years during which the proclamation under subsection (a) is made."

The CHAIRMAN. Now, Senator Sparkman is here.

Senator, would you like to interrogate or shall we call the next group of witnesses?

Senator SPARKMAN. I do not have any questions at this time.

The CHAIRMAN. We have with us now representatives of the farm organizations who are to make a panel on farm aspects of the problem.

Gentlemen, will you come forward, please?

We have Mr. W. E. Hamilton, Mr. Angus McDonald, and Mr. Herschel D. Newsom.

I suggest that we hear the opening statements of all three witnesses without interruption, before the members of the committee begin their questioning.

We would like you to confine yourselves each to 10 minutes, if you can. That will give the members of the committee an opportunity to question you.

You may file your entire statement in the record, of course. And you may insert anything else you consider germane to your statement.

We will start with Mr. Hamilton.

STATEMENT OF W. E. HAMILTON, DIRECTOR OF RESEARCH, AMERICAN FARM BUREAU FEDERATION

Mr. HAMILTON. Thank you, Mr. Chairman. We appreciate the opportunity to comment on the Economic Report submitted to Congress by the Eisenhower administration and the supplemental messages thus far submitted by President Kennedy.

Our remarks will be confined to a few major points.

Our present economic situation is a mixture of favorable and unfavorable factors. Although there has been a slight contraction in business activity in recent months, it would be premature to conclude that we are in a serious recession.

Many of our economic indicators are still at a very high level.

The annual rate of total gross production was higher in the fourth quarter of 1960 than in any previous fourth quarter, even though it was down $1.5 billion from the peak reached in the second quarter.

The fourth quarter rate of personal consumption expenditures was the highest on record. There has been an undesirable increase in unemployment, but more people were working in December 1960 than in any previous December.

The underlying strength of our economy, manifested in final demand for goods and services, gives us great confidence in the future.

At the same time, the record of the past 20 years, the upward trend in Federal spending, and the continuing pressure for more Government intervention in economic affairs cause us to believe that inflation will continue to be a serious problem in the years immediately ahead.

No one can question the desirability of improving the performance of our economic system. The question is whether this objective would be advanced or retarded by increased Government intervention in economic affairs.

The Government can do a great deal in the management of its fiscal and monetary affairs to create a favorable climate for economic activity; however, we do not believe that economic well-being can be improved on a continuing basis by deficit spending or increased intervention in private economic activities. We cannot expect the economy to grow continuously at a uniform rate, because it is humanly impossible to avoid mistakes. When business is good there is a national tendency to overexpand capacity and inventories. In time this creates a need for readjustments which temporarily interrupt economic growth.

The unemployment problem is a good example of the need to take a careful look at the probable effects of increased Government intervention in economic affairs. There can be little question but what rising wage costs have reduced employment by encouraging automation, and making it more difficult for many U.S. industries to compete in the world market. Under such circumstances it would be extremely unwise to increase the statutory minimum wage or expand its coverage. Such an artificial stimulus to higher wage rates would hurt the very people it is supposed to help by reducing the number of jobs available to the inexperienced and unskilled workers who already account for a high percentage of total unemployment.

Farmers have a very great interest in economic growth. Agriculture needs both larger markets and the opportunity for underemployed rural people to find off-farm work. Farmers also have a very great interest in measures which will stabilize the general price level and prevent further inflation.

Recent discussion of farm problems has tended to obscure the fact that farmers have been hurt more by rising costs than by falling prices. Farm prices have been held down by surpluses. Production costs have been boosted by inflation, which has reduced the purchasing power of the dollar, and also by the ever-increasing use of purchased supplies. The alltime high for net farm income was $17.3 billion in 1947, when gross income was $34.4 billion. In 1960, gross income totaled an estimated $37.9 billion—$3.5 billion above 1947 and the second highest on record—but higher costs pulled net income down to $11.6 billion. Thus, gross farm income has gone up $3.5 billion since 1947, but production expenses have gone up $9.3 billion and net farm income has dropped $5.7 billion. The result is a serious cost-price squeeze which would only be made worse by further inflation.

We recognize that deficit spending is not the sole source of inflationary pressures; however, it is a very frequent source of such pressures.

In keeping with our desire to avoid further inflation Farm Bureau believes that Federal spending should be held within the limits of expected revenues under current conditions. We fully subscribe to the argument against increasing Federal expenditures for pump-priming purposes, which was well stated by President Kennedy's task force on the balance of payments problem in the following words:

> * * * even in a recession the Government should continue to make its decisions about expenditure programs on the basis of the on-going needs of the Nation for public services and facilities. It should not try to step up Federal spending, which does not meet this test, in order to counter the recession. Countering a mild and short recession by emergency public spending does not work well in practice. With even minimal lags most of the actual increase in

spending will come after it is no longer appropriate. Moreover, such emergency spending programs would, in practice, establish a needlessly higher expenditure plateau from which the next increase would occur.

The balance of payments situation provides an additional reason for avoiding inflationary action at this time.

At this point I would like to call attention to some material in the Economic Report with regard to the 1959 Census of Agriculture. It shows some interesting things on the trends in farm size. In the interest of time I will skip over the detail but I would like to offer an additional table for the record.

(The additional statement and table referred to follow:)

Trends in Farm Size

In view of this committee's continuing interest in important economic trends, we would like to call attention to the section of the economic report which discusses some of the results of the 1959 Census of Agriculture. We have made some additional computations on the basis of the preliminary census reports for 48 States—excluding Alaska and Hawaii.

The following significant shifts took place between 1954 and 1959:

(1) The total number of farms dropped 22.6 percent. A little more than one-fifth of this decline resulted from a change in definition which eliminated units of less than 10 acres unless they had gross annual sales of at least $250. The remaining four-fifths of the decline represents an actual change in the number of farm units.

(2) The number of farms with gross sales of $10,000 or more increased 36.2 percent.

(3) The number of farms with gross sales of less than $10,000 dropped 30.8 percent with most of the decline taking place at the lower end of the scale. The drop was 39 percent for farms with gross sales of less than $2,500; 24 percent for those with sales of $2,500 to $4,999, and 7.6 percent for those with sales of $5,000 to $9,999.

Stated another way—

Farms with gross sales of $10,000 or more increased from 12.2 to 21.5 percent of all farms.

Farms with gross sales of $5,000 to $9,999 increased from 14.8 to 17.6 percent of the total.

Farms with a gross of $2,500 to $4,999 decreased slightly from 16.9 percent of the total in 1954 to 16.7 percent in 1959.

Farms with gross sales of less than $2,500 decreased from 56 percent of the total in 1954 to 44.1 percent in 1959.

Number of farms in the United States, by economic class, 1954 in comparison with preliminary 1959 data, 48 States [1]

Economic class	1954 census: Gross value of products sold per farm, 1954	1954 census: Number of farms, 1954	Economic class	1959 census, preliminary: Gross value of products sold per farm, 1959	1959 census, preliminary: Number of farms, 1959	Percent change, 1954 to 1959
Commercial farms:			Commercial farms:			
Class I	$25,000 or more	134,003	Class I	$40,000 or more	102,142	
Class II	$10,000 to $24,999	448,945	Class II	$20,000 to $39,999	209,975	
			Class III	$10,000 to $19,999	481,884	
Subtotal, classes I–II	$10,000 or more	582,948	Subtotal, classes I–III	$10,000 or more	794,001	36.2
Class III	$5,000 to $9,999	706,929	Class IV	$5,000 to $9,999	652,938	−7.6
Class IV	$2,500 to $4,999	811,965	Class V	$2,500 to $4,999	616,839	−24.0
Subtotal, classes I–IV	$2,500 or more	2,101,842	Subtotal, classes I–V	$2,500 or more	2,063,778	−1.8
Class V	$1,200 to $2,499	763,348	Class VI	$50 to $2,499 [2]	348,382	
Class VI	$250 to $1,199 [3]	462,427				
Other farms:			Other farms:			
Part-time	$250 to $1,199 [4]	574,575	Part-time	$50 to $2,499 [5]	882,371	
Residential	Under $250	878,136	Part-retirement	$50 to $2,499 [6]	403,696	
Subtotal	Less than $2,500	2,678,486	Subtotal	Less than $2,500	1,634,449	−39.0
Abnormal		2,693	Abnormal		3,099	15.1
Total, all farms		4,783,021	Total, all farms		3,701,326	−22.6
Reduction from 1954					[7] 1,078,774	
Reduction from 1954 due to new definition.					[7] 231,862	

[1] Excludes Hawaii and Alaska.
[2] With the operator working off the farm less than 100 days, and farm sales greater than other family income.
[3] With the operator working off the farm 100 days or more, or other family income exceeding farm sales.
[4] With the operator under 65 years of age, working off the farm less than 100 days and farm sales greater than other family income.
[5] With the operator under 65 years of age, working off the farm 100 days or more, or other family income exceeding farm sales.
[6] With the operator 65 years of age or over.
[7] Based on actual count; other figures are based on a sample enumeration.

Mr. HAMILTON. I would like to point out briefly that there has been a decline in the total number of farms. However, this decline was almost entirely in the number of farms with gross sales of $2,500 or less. There was a very substantial increase in the number of farms with gross sales of $10,000 or more.

A new breakdown presented for the first time in the 1959 census indicates that 54 percent of the farms with gross sales of less than $2,500 are part-time units with operators that worked off the farm 100 days or more or other family income exceeding farm sales. Another 24.7 percent are part-retirement units with operators 65 years of age or over. Only 21.3 percent of the farms with a gross of less than $2,500 failed to classify as part time or part retirement.

In summary, the new census figures make it clear that family farms are adjusting to the size of business needed for commercial operations and that the great majority of really low production farms are primarily residences rather than farms.

NEEDED CHANGES IN FARM LEGISLATION

The most urgent need for new farm program legislation is to help farmers correct the unsatisfactory conditions that have developed in wheat and feed grains.

Table I shows the output-use picture of wheat and feed grains in recent years and current carryovers.

TABLE I.—*Average output, disappearance, and carryover of wheat and feed grains, 5 crop-years, 1956–60*

Crop	Average production	Average use [1]	Production as percentage of use	Estimated 1961 carryover	Estimated 1961 carryover as percentage of 1960–61 use
Wheat.............million bushels..	1,181	1,091	108	1,526	132
Corn.............do....	3,862	3,678	105	2,094	52
Sorghum grain.............do....	521	402	130	675	124
4 feed grains [2].............million tons..	152.5	144.8	105	85.6	54

[1] Including exports.
[2] Includes corn, sorghum grain, oats, and barley.

The above table indicates that production of feed grains and wheat has been running 5 to 8 percent above disappearance in recent years. As a result we have accumulated carryover stocks equal to approximately 16 months' disappearance in the case of wheat and 6 months' disappearance in the case of feed grains, the most important of which is corn. In relation to use carryover stocks are almost as high for sorghum grain as for wheat; however, sorghum is a relatively small part of the total picture.

The wheat program is a classic example of the difficulties involved in any attempt to fix prices and control production legislatively. The feed situation has been seriously aggravated by programs that have diverted millions of acres from controlled crops to feed grains, oilseeds, and forage.

It makes no sense at all to restrict production of one grain and let producers plant their diverted acres to another grain. We must face up to our surplus capacity problem on an overall basis.

Farm Bureau's recommendations for doing this are set forth in the following policy resolution entitled "Cropland Adjustment Program":

In order to assist growers of feed grains, wheat, soybeans, and flax in adjusting production to market needs and provide for an orderly liquidation of Government surpluses, we reaffirm our support of a properly designed and administered program to adjust production through land retirement.

Specifically, we recommend a temporary program which provides that—

(1) The Secretary of Agriculture shall determine annually the overall acreage adjustment of feed grains, wheat, soybeans, and flax necessary to bring production in line with anticipated disappearance. The Secretary shall also establish annually the percentage of cropland which must be placed under contract to qualify for price support on these commodities.

(2) To be eligible for price supports on wheat, feed grains, soybeans, and flax, producers must participate in the cropland adjustment program. Cropland already in a retirement program shall be counted in determining compliance with this requirement. Producers of other commodities may also participate. (Whole farm participation should be encouraged.) Any cropland retired under the program in excess of the minimum requirement for price support must be placed under contract for at least 3 years.

(3) Cropland adjustment payments shall be made at a level which will encourage sufficient voluntary participation to attain the desired adjustment.

(4) Adjustment payments may be made in cash or in kind. Emphasis should be placed on payment in kind, with care to minimize disturbance of the market price structure for grain.

(5) Cropland retired under this program must be in addition to land normally left idle or fallowed.

(6) Acreage retired under the program may not be harvested or grazed.

(7) A maximum limit shall be placed on the percentage of cropland acreage that may be retired in any county after allowing for the minimum acreage required for price support. Acreage retired under previous programs shall not prevent participation in the annual adjustment programs.

(8) Wheat acreage allotments shall be terminated.

(9) The price support level on corn shall be related to the average price received by farmers during the immediately preceding 3 years. The support levels for other feed grains and wheat shall be comparable to the level for corn with adjustments for differences in weight, nutritive value, buyer preference, and supply-demand conditions.

(10) Adequate measures shall be taken to protect farmers from the competition of Commodity Credit Corporation sales from accumulated stocks.

The cropland adjustment program outlined above proposes to remove a basic cause of continuing low farm income by starting an immediate reduction of the agricultural productive plant to a size which will better fit farm output to market needs and open the way to orderly liquidation of accumulated Government stocks. It provides for voluntary participation by producers of all crops but requires producers who wish to qualify for price support on wheat, feed grains, soybeans, and flax to participate.

Assuming the market growth over the next few years will be at least proportional to output growth due to improving yields per acre, a reduction in output of 5 to 7.5 percent will just about balance current production with current market needs. Any output reduction in excess of this amount will provide opportunity to start liquidation of Government stocks; however, experience with past land retirement efforts indicates that the percentage cut in acreage would have to be substantially larger than the indicated percentage reduction in output in order to balance supplies with demand.

In other words, you cannot expect to get a cut in output that is exactly proportional to the cut that you make in acreage.

Table II shows approximate cropland acreage nationally, how the acreage currently is being used, and what the status of land devoted to specified crops would be under the proposed adjustment program.

(The table referred to follows:)

TABLE II.—*U.S. cropland acreage by principal uses*

CROPLAND—GROUPED BY PRINCIPAL USE	*Planted acreage, thousands*
Group A.—To be supported (without acreage controls)[1] (producers of these commodities desiring price support must participate in the proposed cropland adjustment program):	
Corn, all	82,906
Wheat, all[2]	55,633
Oats, barley, rye	52,177
Sorghum, for grain	15,444
Soybeans, for beans	23,516
Flax, all	3,527
Total—Group A	233,203
Group B.—To be supported (with acreage controls)[1] (participation in the proposed cropland adjustment program is not required for price support on these commodities):	
Cotton	16,068
Rice	1,614
Peanuts	1,579
Tobacco	1,144
Total—Group B	20,405
Group C.—Other crops and uses:[3]	
Conservation reserve	[4]28,432
Hay, cropland pasture, other crops, fallow, idle, failure, etc	177,609
Total—Group C	206,041
Total cropland, all uses[3]	459,649

[1] Planted acreage for 1960 as reported by USDA.

[2] Currently supported and controlled, but controls to be terminated under Farm Bureau proposal.

[3] 1954 U.S. Census of Agriculture—data now used by USDA in land retirement computations. New census data to be available in about 6 months.

[4] Under contract in 1960.

Under our proposal all land listed in table II under Groups A, B, and C—except for an amount in group C equal to that which is customarily summer fallowed or left idle—would be eligible for the land-retirement program on a voluntary basis.

The acreage allotments applicable to crops listed in group B would not be affected by the cropland adjustment program; however, farmers entering the program to qualify for price supports on a grain or oilseed crop would be required to retire a designated percentage of their total cropland.

The proposed cropland adjustment program includes a new wheat price-support plan whereby the national level of support for wheat would be comparable to the national level for corn after adjustment for differences in weight per bushel, nutritive value, buyer preference, and supply-demand conditions. Under a relatively free market system there is, of course, normally a considerable range between market prices of the lower and higher grades of wheat.

In order to insure that market prices of all commodities affected by this program reflect the full value as determined by the current year's production relative to demand, the proposal calls for steps to minimize competition from CCC surplus holdings. A major need in this area is to increase the margin between support prices and the prices at which the CCC can sell accumulated stocks for unrestricted use. This I might add could be done by the Secretary of Agriculture under administrative authority he already has.

The cropland adjustment program is a package proposal. It is designed to achieve needed adjustments in grain production on a basis consistent with individual choice in a market system. While we have proposed that participation in the cropland adjustment program be made a condition of eligibility for price support on wheat, feed grains, and oilseeds, major emphasis is placed on the use of cropland adjustment payments to encourage voluntary participation on the part of producers of all commodities in a land retirement program.

Under such an approach it is essential that the price-support program be made consistent with production objectives. This means that price supports should facilitate orderly marketing rather than fix prices at artificial levels. By encouraging voluntary adjustments in land use the cropland adjustment program will get adjustments in the areas and on the farms where they are most needed. The provision for the voluntary retirement of whole farms will make it possible for some individual farmers to retire or shift to off-farm work. At the same time it will reduce the amount of cropland other farmers will have to retire as a condition of eligibility for price support.

You will note that we are in agreement with the principal recommendations of the President's overall agricultural task force—the group headed by Dean J. Norman Efferson of Louisiana State University.

We are in disagreement with the recommendations of the President's task forces on wheat and feed grains.

As the Efferson group said, "We believe it would be unwise to raise price supports for wheat and corn under present circumstances." An increase in price supports would increase program costs, and encourage efforts to increase per acre yields. Eventually such a program would mean increased Government control of individual farming operations, reduced efficiency, smaller markets, increased export program costs and the capitalization of program benefits. Farm Bureau's cropland adjustment program moves in the opposite direction.

Current proposals for a three-price plan on wheat are completely unacceptable to Farm Bureau. We now have a two-price plan since the export subsidy program permits foreign buyers to purchase wheat at prices averaging approximately 60 cents per bushel less than the U.S. price. The plan recommended by the task force on wheat would maintain this separation of the foreign and domestic markets, and permit surplus wheat to be sold domestically for livestock feed at a third price.

Such a plan would have the effect of dumping surplus wheat into the feed market on an unfair, subsidized basis—thus adversely affecting the incomes of all producers of feed grains and livestock, dairy

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and poultry products. Wheat producers have a right to compete for a share of the feed market; but only if they are willing to compete on a fair basis.

As recommended by the wheat task force, the three-price plan would treat surplus disposal (including giveaways and foreign currency sales) as a primary use of wheat; dramatically increase the Treasury cost of all wheat exports, including dollar sales; divide up the market for "primary use" wheat without regard for differences in quality or actual use in the primary market; disrupt the marketing of flour mill byproducts; increase consumer prices and destroy the futures market for wheat.

In order to solve the total grain problem without creating extensive new problems, wheat must be placed on a comparable basis with corn and other feed grains. This is what the Farm Bureau's cropland adjustment program proposes to do.

In conclusion I want to emphasize our belief that a change in the direction of agricultural policy is long overdue. The cropland adjustment program is a practical approach to the solution of problems that have been aggravated by past programs. It is a voluntary program. It moves away from the detailed regulation of individual farming operations. It seeks to reduce total production—not just to shift the surplus problem from one group of producers to another. It will reduce export program costs immediately, and total program costs as production is brought into a better balance with effective market demand.

The adoption of such a program would be a real step forward in agricultural policy.

The CHAIRMAN. Thank you, Mr. Hamilton. Now, Mr. Angus McDonald.

STATEMENT OF ANGUS McDONALD, ASSISTANT DIRECTOR OF LEGISLATIVE SERVICES OF THE NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman and members of the committee, we appreciate the opportunity to express our views on the Economic Report of ex-President Eisenhower and to make a few brief comments on actions of President Kennedy. Although we realize that the past administration disagreed substantially with the announced policies of the present administration, we believe that the Eisenhower report represents a partial agreement in principle and that its study by this committee will be constructive.

Although the National Farmers Union was in substantial disagreement with the policies of the previous administration, particularly those of Secretary of Agriculture Benson, we believe that there has been substantial improvement to the policies in certain areas. For example, previously a bill providing for assistance in regard to pollution abatement was vetoed and although a subsequent bill authorizing funds was opposed and discretionary authority was used to cut funds; apparently, the administration had a change of heart and recommended an authorization of $50 million, which sum had been firmly opposed until the budget message of January 1961. There is also an awareness in the Economic Report of the problems of depressed areas, unemployment, resource development, and farm depression. We believe that such a moderation of views will be beneficial in this Congress.

The position of the past administration until recently represented a philosophy which would have been more applicable in the 19th century. We do not intend to disparage such a philosophy based primarily on laissez-faire economic theory but we emphasize that modern technology, economic concentration, and control by a few managers and directors have changed the face of America and consequently new programs, new regulations, and new policies by the Central Government are necessary.

The Federal Government, we believe should provide the leadership, both in regard to welfare and resource programs—a horse-and-buggy philosophy, to use a trite phrase, is completely out of date. However, we wish to praise certain activities relating to antitrust law enforcement. The celebrated cases which have been in the headlines for many months and which have resulted in criminal penalties, which included jail sentences for big businessmen, is a landmark in the attempts of the Federal Government to preserve our free enterprise system.

Although not generally admitted, we believe that practices which were exposed by the Department of Justice in the electric power industry cases are likewise practiced in a number of other industries. Attention is called to the attached tables which indicate collusive bidding on Government contracts.

I call particular attention to the table on page 2 of the appendix in regard to the price of portland cement. Delivered from San Francisco, Calif., this is the appendix I am referring to which is attached to my statement——

Senator DOUGLAS. If I may interject, that shows that although there is a delivery point of Friant, Calif., the firms in Los Angeles, San Francisco, Oakland had identical quotations of $3,888.64.

Mr. McDONALD. Yes, sir.

Now, I might go on to say that the General Services Administration under the law is authorized to refer to the Department of Justice information in regard to such pricing when it is felt that there might be a possibility of collusive bidding and violation of the law.

According to an article by Professor Mundt in the Journal of Political Science, July 1958, where I got this material, there are 10,000 such instances which have been referred to the Department of Justice.

Senator BUSH. Where are you reading from, Mr. McDonald?

Mr. McDONALD. Senator, I departed from my text.

We suggest that this committee study prices which are not responsive to supply and demand with a view toward bringing about better enforcement of the antitrust laws, and greater responsibility on the part of industrial leaders. We are inclined to think that those who have been carrying on these practices are in part responsible for the current recession.

It is a well-known fact that farm prices and incomes have not kept pace with national income or industrial prices for a period of years. For example, the index of the Bureau of Labor Statistics indicates (using 1947–49 as a base) that farm products in December 1960 stood at 88.7 and that the prices of all commodities stood at 119.5. Machinery and motor products stood at 153.6 and metal products stood at 152.2. Agricultural machinery equipment stood at 148.4 and agricultural machinery, excluding tractors, stood at 155.7. While prices of other commodities generally were not so disproportionate compared to farm products, they were substantially higher than they were during the base period.

These industries manage in some way to control their prices. Although demand for steel and products made of steel has drastically declined at various times during the last 8 years, prices have been more or less rigid; there has been little decline in any steel products that farmers buy. The trend has been in the opposite direction.

There has been a great deal of discussion about inflation during the last few years. The theory of the past administration is that inflation can be controlled by monetary policy (ex-President Eisenhower's report emphasizes this). I quote from the report, page 58:

> * * * The second major Government instrument for controlling inflationary tendencies in monetary policy, for which the independent Federal Reserve System is responsible.

The trouble with the application of such a theory is that the tight money policies does not necessarily reach industries where prices are unduly high. According to the Department of Commerce, corporations have been depending primarily on the so-called internal financing which means that they have been financing out of profits. In other words, the corporation does not need to go to the bank when it needs to build or modernize a plant. It merely finances out of profits. Tightening bank credit or raising the interest rate does not substantially affect those where this situation exists. The tight money, high interest policies, however, do affect small business, agriculture, and particularly housing, since most builders operate on borrowed money. We agree with conclusions reached in certain reports of this committee that experience in the recessions of 1954, 1958, and 1960 have proved the monetary control theory to be fallacious.

We are hopeful that misguided policies of the last 8 years will be reversed. We applaud the action which increased the amount of food distribution to those in depressed areas. According to President Kennedy the Commodity Credit Corporation value of the food distributed only amounted to 5 cents a day per person. We hasten to add that even doubling this piddling amount of food does not afford adequate nutrition to needy persons.

I have an exhibit here which I would like to show the committee, which indicates that the amount of food distributed to the needy and unemployed per day amounted to 5 ounces of flour, 2½ ounces of dried skim milk, 3 ounces of corn meal, one-half ounce of rice, and one-eighth ounce of powdered eggs. It is apparent, members of the committee, that doubling this ration will not very substantially meet the nutrition requirement.

Senator DOUGLAS. I may say that the chairman of the committee which made the recommendation that the food allowance be doubled—I was well aware of this fact, Mr. McDonald—simply felt this was the total amount which could be increased by administrative order and that to do more, and to purchase citrus fruits and so forth, and meats, would probably require legislative action. I agree with you thoroughly. I merely want to say that the President in carrying out our recommendations acted to the full extent within the power which he, himself, possessed.

Mr. McDONALD. Although the outlook in regard to agriculture and employment is grim, we are hopeful that recent emergency measures taken by the Kennedy administration will soon take effect and that eventually a long-range farm program will be enacted which will bring production in balance with consumption.

(The tables referred to are as follows:)

APPENDIX 1

TABLE 1.—*Representative examples of identical bidding*

POTENTIAL TRANSFORMER, BUREAU OF RECLAMATION, JAN. 16, 1958

Delivery point	Bidder	Terms	Unit price
			Each
Coulee Dam, Wash	Westinghouse Electric Corp., Sharon, Pa.	Net	$2,695.00
Do	General Electric Corp., Holyoke, Mass	do	2,695.00
Do	Allis-Chalmers Manufacturing Co., Pittsburgh.	do	2,695.00

ROCK SALT, GENERAL SERVICES ADMINISTRATION, JULY 23, 1954

Delivery point	Bidder	Terms	Unit price
			Per 100 pounds
Atlanta, Ga	Carey Salt Co., Atlanta	Net	$1.19
Do	International Salt Co., Atlanta	do	1.19
Do	Morton Salt Co., Chicago	do	1.19
Do	Pioneer Salt Co., Philadelphia	do	1.19

ROCK SALT, COUNTY OF ALLEGHENY, PA., AUG. 5, 1958

Delivery point	Bidder	Terms	Unit price
			Per ton
Allegheny County, Pa	E. J. Fedigan, Pittsburgh	Net	$22.40
Do	International Salt Co., Pittsburgh	do	22.40
Do	Morton Salt Co., Wadsworth, Ohio	do	22.40

SOIL STERILANT [1], DEPARTMENT OF THE ARMY, MAR. 6, 1958

Delivery point	Bidder	Terms	Unit price
			Per pound
Auburn, Wash	Associated Sales Supply, St. Louis	2 percent, 20 days	$3.00
Do	Van Waters & Rogers, Seattle	do	3.00
Do	Arizona Fertilizers, Phoenix	do	3.00
Do	Steve Regan Co., Salt Lake City	do	3.00
Do	E. C. Olsen Co., Ogden, Utah	do	3.00

YEAST, DEPARTMENT OF THE ARMY, NOV. 17, 1954

Delivery point	Bidder	Terms	Unit price
			Per pound
Richmond, Va	Anheuser-Bush, St. Louis	Net	$0.1450
Do	Standard Brands, Richmond, Va	do	.1450
Do	Red Star Yeast Corp., Milwaukee	do	.1450
Do	Federal Yeast Corp., Philadelphia	do	.1450

MASONRY CEMENT,[2] DISTRICT OF COLUMBIA, AUG. 1, 1956

Delivery point	Bidder	Terms	Unit price
		Terms	*Per sack*
Warehouse, Washington, D.C., or Lorton, Va.	United Clay Products, Washington, D.C	2 percent, 30 days	$0.9875
Do	Cushwa Building Supply, Washington, D.C.	do	.9875
Do	Eckington Building Supply, Washington, D.C.	do	.9875
Do	Hudson Supply, Washington, D.C	do	.9875
Any point, Washington, D.C.	A. P. Woodson Co., Washington, D.C	do	.9875
Do	United Clay Products, Washington, D.C	do	1.025
Do	Cushwa Building Supply, Washington, D.C.	do	1.025
Do	Eckington Building Supply, Washington, D.C.	do	1.025
Do	Hudson Supply, Washington, D.C	do	1.025
Do	A. P. Woodson Co., Washington, D.C	do	1.025

See footnotes at end of table, p. 240.

TABLE 1.—*Representative examples of identical bidding*—Continued

PORTLAND CEMENT, BUREAU OF RECLAMATION, OCT. 23, 1957

Delivery point	Bidder	Terms	Unit price
			896 barrels
Friant, Calif	Monolight Portland Cement, Los Angeles	Net	$3,888.64
Do	Pacific Cement, San Francisco	do	3,888.64
Do	Permanente Cement, Oakland	do	3,888.64
Do	California Portland Cement, Los Angeles	do	3,888.64
Do	Calaveras Cement, San Francisco	do	3,888.64

TYPEWRITERS (11-INCH STANDARD), COUNTY OF ALLEGHENY, PA., SEPT. 30, 1958

Delivery point	Bidder	Terms	Unit price
			Each
Allegheny County, Pa	Royal-McBee Corp., Pittsburgh	Net	$193.50
Do	Underwood Corp., Pittsburgh	do	193.50
Do	Smith-Corona-Marchant, Pittsburgh	do	193.50
Do	Remington Rand, Pittsburgh	do	193.50

CALCIUM CHLORIDE, FLAKES, CITY OF NEW YORK, SEPT. 9, 1958

Delivery point	Bidder	Terms	Unit price
			Per ton
New York City	Robinson Bros. Chemicals, Barberton, Ohio.	Net	$31.00
Do	Allied Chemical Corp., Solvay, N.Y	do	31.00
Do	Thompson Materials Corp., Midland, Mich.	do	21.00

POTENTIAL TRANSFORMER, BUREAU OF RECLAMATION, MAY 2, 1958

Delivery point	Bidder	Terms	Unit price
			Each
Sioux Falls, S. Dak	Standard Transformer Co., Warren, Ohio.	Net	$585.00
Do	General Electric Co., Holyoke, Mass	do	600.60
Do	Westinghouse Electric, Sharon, Pa	do	600.60
Do	Allis-Chalmers Manufacturing Co., Pittsburgh.	do	600.60

SODIUM FLUORIDE, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, SEPT. 24, 1957

Delivery point	Bidder	Terms	Unit price
			Carload
Grand Rapids, Mich	Blackson Chemical Co	Net, 30 days	$4,290.00
Do	Arthur S. Lapine Co	do	4,290.00
Do	Allied Chemical Corp	do	4,290.00
Do	Seebee Paint Chemical Corp	do	4,290.00
Do	American Agricultural Chemical Corp	do	4,290.00

GRAPHITE AEC, OAK RIDGE OPERATION, OCT. 1, 1958 [3]

Delivery point	Bidder	Terms	Unit price
			Per 100 pounds
Oak Ridge, Tenn	Speer Carbon Co., Niagara Falls, NY	Net, 30 days	$30.25
Do	National Carbon Co., Niagara Falls, N.Y., Columbia, Tenn.; Clarksburg, W.Va.	do	$30.25
Do	Great Lakes Carbon Co., Niagara Falls, N.Y.	do	30.25

TETRACYCLINE, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, SEPT. 13, 1958 [4]

Delivery point	Bidder	Terms	Unit price
			Per 100 capsules
Perry Point, Md	Pfizer	Net	$19.188
Do	Squibb	2 percent, 30 days	19.58
Do	Upjohn	do	19.58
Do	Bristol	do	19.58
Do	Lederle	do	19.58

See footnotes at end of table, p. 240.

TABLE 1.—*Representative examples of identical bidding*—Continued

Delivery point	Bidder	Terms	Unit price
LIGHTNING ARRESTORS, BUREAU OF RECLAMATION, SEPT. 26, 1955			
			Each
Yankton, S. Dak	Graybar Electric, Denver, Colo	Net	$1,103.64
Do	Ohio Brass Co., Mansfield, Ohio	do	1,103.64
Do	Westinghouse Electric, Denver, Colo	do	1,103.64
Do	General Electric, Denver, Colo	do	1,103.64
MAGNESIUM ALLOY SHEETS, DEPARTMENT OF AIR FORCE, MAY 13, 1958			
			Per pound
Tinker Air Force Base, Okla.	Continental Metals, Los Angeles	Net	$1.191
Do	Dow Chemical, Midland, Mich	do	1.191
Do	Brooks, & Perkins, Detroit	do	1.191
LIQUID CHLORINE, BUREAU OF RECLAMATION, JUNE 19, 1958			
			6,480 pounds
Boulder City, Colo	Pacific Engineering Co., Henderson, Nev	Net	$810.00
Do	Tops Chemical Co., Duarte, Calif	do	810.00
Do	Van Water & Rogers, Los Angeles	do	810.00
Do	McKesson & Robbins, Los Angeles	do	810.00
CARBON DIOXIDE (DRY ICE), GENERAL SERVICES ADMINISTRATION, NOV. 29, 1955			
			Per pound
Washington, D. C	Cardox Corp., Chicago	Net	$0.035
Do	Liquid Carbonic, Chicago	do	.035
Do	Olin Mathieson, Baltimore	2 percent, 30 days	.035
Do	Pure Carbonic, New York City	Net	.035
ZINC OXIDE, U.S. NAVY, APR. 29, 1954			
			Per pound
Norfolk, Va	American Zinc Sales Co., Columbus, Ohio	Net	$0.1336
Do	New Jersey Zinc Sales Co., New York City	do	.1336
Do	Eagle-Picher Sales Co., Philadelphia	do	.1336
N 155 ALLOY SHEETS, AEC, OAK RIDGE OPERATIONS OCT. 28, 1958 [6]			
			Per pound
Oak Ridge, Tenn	Universal Cyclops Steel Corp., Bridgeville, Pa.	½ percent, 10 days	$2.67
Do	Haynes Stellite Co. (division of Union Carbide), Kokomo, Ind.	Net 30	2.67
STRANDED CONDUCTOR PAPER AND LEAF, CITY OF CLEVELAND, SEPT. 18, 1958			
			Per 100 feet
Cleveland, Ohio	General Cable Corp., Cleveland	½ percent, 10 days	$119.10
Do	American Steel & Wire Co., Cleveland	do	119.10
Do	Okonite Co., Passaic, N.J	do	119.10
Do	Phelps Dodge Copper Products Co., New York City.	do	119.10
Do	John A. Roebling's Sons, Trenton, N.J	do	119.10
NETWORK TRANSFORMERS CITY OF AUSTIN, TEX., MAR. 24, 1958			
			Each
Austin, Tex	Walter Tips (Westinghouse) [7]	Net	$7.464
Do	Sterett Supply Co. (Kuhlman Electric) [7]	do	7.464
Do	Priester Supply Co. (Maloney Electric) [7]	do	7.464
Do	General Electric Co. (General Electric) [7]	do	7.464
Do	Southern Electric Supply Co. (Allis-Chalmers).[7]	do	7.464

See footnotes at end of table, p. 240.

TABLE 1.—*Representative examples of identical bidding*—Continued

PAPER CUPS (9-OUNCE), STATE OF VIRGINIA, NOV. 13, 1958

Delivery point	Bidder	Terms	Unit price
			Per thousand
Blacksburg, Va	Consolidated Paper & Box	2 percent, 10 days.	[8] $6.18
Do	Hamilton Paper Corp	do	6.18
Do	Frank G. Ennis Paper Co	do	6.18
Do	Dillard Paper Co	do	[9] 6.18
Do	Epes Fitzgerald Paper Co	do	6.18
Do	Hampton Roads Paper Co	do	6.18
Do	Southern Paper Supply	do	6.18
Do	Dettor Edwards & Morris	do	6.18

POLIO VACCINE, CITY OF NEW BRITAIN, CONN., OCT. 6, 1958

			Vial
New Britain, Conn	Pitman-Moore Co	Net	$3.9592
Do	Eli Lilly & Co	do	3.9592
Do	Merck, Sharp & Dohme	do	3.9592
Do	Parke, Davis & Co	do	3.9592
Do	Sisson Drug Co	do	3.9592

[1] Telvar W (or equal), a patented product manufactured by DuPont.
[2] To be supplied during the period Sept. 1, 1956, to Feb. 28, 1957.
[3] All bidders agreed to equalize freight.
[4] All prices are identical, discount considered.
[5] The award was made to Olin Mathieson because of the more favorable discount.
[6] This award was made to Universal Cyclops.
[7] Suppliers.
[8] Lilly No. 957.
[9] Dixi No. 185.

TABLE 2.—*Representative examples of competitive bidding*

BEDSPREADS, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE, SEPT. 26, 1958

Delivery point	Bidder	Terms	Unit price
			Each
Bethesda, Md	Geo. D. Brandt Co., New York City	1 percent, 20 days.	$4.9994
Do	Kuttnauer Manufacturing Co., Detroit, Mich.	do	5.33
Do	Guy Curran & Co., Washington, D.C.	do	5.13

HYDROCHLORIC ACID, AEC, OAK RIDGE OPERATIONS, JULY 31, 1958

			Tank car lots, per ton
Oak Ridge, Tenn	Tennesse Products & Chemical Corp., Nashville.	Net, 30 days	$18.00
Do	Monsanto Chemical, St. Louis	do	26.49
Do	Columbia Southern Chemical, Charlotte, N.C.	do	30.10
Do	Dow Chemical Co., Midland, Mich	do	26.34
Do	E. I. du Pont de Nemours, Wilmington, Del.	do	26.53

ARGON GAS, AEC, OAK RIDGE OPERATIONS, AUG. 5, 1958

			240 cubic foot cylinders; per 100 cubic feet
Oak Ridge, Tenn	Alabama Oxygen Co., Birmingham	Net, 30 days	$11.00
Do	Southern Oxygen Co, Kingsport, Tenn	do	6.20
Do	Air Reduction Sales Co., Houston	do	6.50
Do	National Cylinder Gas, Knoxville, Tenn	do	5.50
Do	Marks Oxygen Co., Augusta, Ga	do	6.15
Do	Welding Gas Products, Chattanooga	do	10.00
Do	Linde Co. (division of Union Carbide & Carbon Co.), Knoxville, Tenn.	Net, 10 days	4.50

See footnotes at end of table, p. 242.

TABLE 2.—*Representative examples of competitive bidding*—Continued

ACETONE, AEC, OAK RIDGE OPERATIONS, AUG. 12, 1958

Delivery point	Bidder	Terms	Unit price
			Tank car lots; per gallon
Oak Ridge, Tenn	Enjoy Co., New York City	Net, 10 days	$0.56
Do	Octagon Process, Staten Island	Net, 30 days	.559
Do	C. P. Chemical Solvents, New York City	do	.561
Do	Shell Chemical Corp., New York City	do	.561
Do	Phipps Products Corp., Boston	5 percent, 10 days	.50369
Do	Union Carbide Chemicals Co., New York City.	Net, 30 days	.478
Do	Eastman Chemicals Products, Kingsport, Tenn.	do	.495
Do	Allied Chemical Corp., New York City	do	.477
Do	Chemical Compounding Corp, Perth Amboy, N.J.	do	.559

TRAFFIC CONES, CITY OF AUSTIN, TEX., NOV. 28, 1958

Delivery point	Bidder	Terms	Unit price
			Each
Austin, Tex	Interstate Rubber Co., Los Angeles	2 percent, 10 days	$1.55
Do	Sargent & Ewell, Grand Prairie, Tex	do	1.69
Do	Robbins Tire Co., Tuscumbia, Ala	do	1.59
Do	Rohan Co., Waco, Tex	do	2.29

RECORDING WATTMETERS, BUREAU OF RECLAMATION, FEB. 3, 1958 [1]

Delivery point	Bidder	Terms	Unit price
			Each
Palisades, Idaho	Electro-Technical Equip. Co., New York City.	Net	$895.36
Do	Instrument Laboratory, Seattle	do	907.60
Do	Esterline-Angus Co., Indianapolis	do	963.00
Do	Westinghouse Electric, Denver	do	972.40
Do	General Electric, Denver	do	972.40
Do	Phillips & Edwards, San Francisco	do	1,625.00

BACON, SLAB, COUNTY OF SAN DIEGO, MAR. 26, 1958

Delivery point	Bidder	Terms	Unit price
			Per pound
San Diego, Calif	Zest Provision Co., Los Angeles	Net	$0.4972
Do	Oscar Mayer Co., Los Angeles	do	.61
Do	George Hormel & Co., Los Angeles	do	.52
Do	Swift & Co., San Diego	do	.4490

TIRES, NYLON TUBELESS (4-PLY), CITY OF MIAMI, FLA., OCT. 15, 1958

Delivery point	Bidder	Manufacturer	Terms	Unit price	
				Size 7.50 x 14	Size 6.70 x 15
Miami, Fla	Norton Tire Co., Miami	B. F. Goodrich	Net	$19.24	$17.49
Do	General Tire Co., Miami.	General Tire	2 percent, 10 days	19.24	17.49
Do	Aeroland Oil Co., Miami.	do	do	19.24	17.49
Do	Firestone Store, Miami	Firestone	Net	19.24	16.34
Do	Goodyear Service, Miami.	Goodyear	2 percent, 10 days	18.86	17.14
Do	Waldron Tire Co., Miami.	Pennsylvania	do	16.92	15.30
Do	Tire King, Miami	Vanderbilt or Cooper	Net	16.90	14.90
Do	Eagle Tire Co., Miami	Mohawk	do	14.59	13.00
Do	Major Oil Co., Miami	National	do	13.95	13.95
Do	Southeastern Tire Co., Miami.	Armstrong	do	13.40	12.90

See footnotes at end of table, p. 242.

TABLE 2.—*Representative examples of competitive bidding*—Continued

PADLOCKS, U.S. GEOLOGICAL SURVEY, OCT. 9, 1958 [1]

Delivery point	Bidder	Terms	Unit price	
			Without keys	With keys
Silver Spring, Md	Atlantic Hardware & Supply Corp., New York City.	2 percent, 30 days	$1.775	$1.818
Do	Whitlock Corp., Yonkers, N.Y.	do	1.80	1.85
Do	Frederick Trading Co., Frederick, Md.	do	1.83	1.87
Do	Wm. H. Cole & Sons, Baltimore	do	2.06	2.11
Do	Rudolph & West, Washington, D.C.	do	1.88	1.93
Do	May Hardware Co., Washington, D.C.	do	1.82	1.86
Do	W. T. Weaver & Sons, Washington, D.C.	do	1.856	1.90
Do	Fries, Beall & Sharp Co., Washington, D.C.	do	1.81	1.855
Do	Specialty Auto Fabrics Corp., New York City.	Net	1.78	1.93

[1] Frequently large firms match prices, but there is variation in the extent to which the small firms follow.
[2] Master Lock Co., Milwaukee, Wis., was the common supplier of all bidders.

The CHAIRMAN. Thank you, Mr. McDonald. Now, Mr. Newsom.

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE

Mr. NEWSOM. The privilege of presenting our viewpoint annually—from a strictly rural and agricultural perspective, and from a lay point of view, on the subject matter of the President's Economic Report—to this committee is much appreciated.

The time has long past, if indeed it ever was, when as farmers and rural American families we can afford to ignore, to be unconcerned with, decisions that are made or recommendations that are advanced in compliance with the provisions of the Employment Act of 1946. Indeed, it is our plea to the members of this committee that each of you keep in mind the fundamental fact that decisions with respect to nonagricultural industry and nonagricultural labor, as well as those with respect to the monetary and fiscal policies of America, and all related subject matter which comes under the scope of the President's Economic Report, are of vast importance to all of us.

If we may somehow cultivate a universal appreciation of the fact that one man's price or wage in this great interdependent American economy of ours immediately becomes another man's cost, we will be well on our way toward understanding the basic foundation of the so-called farm problem that has confronted us for many years.

There is great significance in the fact that agricultural indebtedness has continued to increase over the past several years, and that the increase during 1960 brought us to a level of approximately 13 percent of all assets, leaving an equity in our agricultural balance sheet of some 3 percent less than it was 12 months ago. This increase in debt has developed in spite of the fact that American agriculture has continued its miraculous and steady improvement in efficiency, which seems clearly to justify a far better level of return on investment and labor than has been received in American agriculture.

But I would just like to hasten to say that this does not justify a conclusion on anybody's part, in our opinion, that we must go to a completely free market; nor does it justify a conclusion that we have to go into rigid governmental controls. Nor do I think—as I probably have stated in this testimony—that any conclusions that contend that we should do that are justified.

What I am trying to say is that I believe many of our contemporaries have never quite understood that the dominant influence on this rising cost-price squeeze that we have talked about so many years in agriculture had its origin in the very earliest days of this Republic when Alexander Hamilton won his debates with Mr. Jefferson on the fundamental premise that we would never have economic and industrial development sufficient to meet the requirement of this country of ours unless we established a protective policy on behalf of our agriculture.

The members of this committee are well aware, but unfortunately some of our contemporaries do not seem to be aware, that two of the most important actions of the very First Continental Congress were predicated on what I refer to here as the Hamiltonian theory of higher excise taxes on foreign-produced or manufactured products, and even tax concessions on American bottoms, in another piece of legislation.

The CHAIRMAN. May I interrupt you briefly?

Mr. NEWSOM. Yes, sir.

The CHAIRMAN. Isn't it a fact that the first law passed by Congress related to what you are talking about?

Mr. NEWSOM. Exactly, as I understand my history.

The CHAIRMAN. The first act, No. 1 act, was to impose a tariff.

Mr. NEWSOM. That is right; in 1789, I believe. I should like to point out, too, that even in my lifetime I think I have seen what I would prefer to refer to in my farm parlance as the second leg on an economic milk stool, generated when following World War I we found that we had an industrial potential for which there was no adequate domestic market. This forced us into a legislative structure predicated on the proposition that we must put purchasing power in the hands of the masses of our industrial workers. Now, I know, as well as anybody, I believe, that there have been abuses out of the power, the economic power, and the political power given to American business by the one action.

I think there have been abuses by certain labor figures as a result of action in my lifetime following World War I, but I think I understand full well, too, that we never could have had the level of economic development and power in this country without both of these steps.

I am saying to you that I believe that the missing third leg on this economic milk stool now is clearly a sound agricultural policy that will give to us in agriculture a reasonable bargaining power, even though we may have to be policed, or discipline may have to be imposed upon us if we are not capable of a degree of self-discipline that is really in the public interest.

I believe that it is just as fundamentally sound for us in agriculture to get an American price level for that which is needed in our domestic economy and to perhaps be relatively free within certain limits to produce for markets beyond our primary market, as it is for labor to enjoy the benefits of collective bargaining and minimum wages, or agreements arising out of a basic workweek with liberty, I think, to drive taxis after hours and all that sort of thing. I do not agree with some of my good personal friends and contemporaries that our problem is basically one of 5 to 8 percent over production in any particular agricultural commodity. I do agree that we need some adjustment processes now to give us an opportunity to reduce carryovers to something that is manageable and workable, and will not continually pose a threat to the market.

All that I am saying is that it is in front of this framework that I have great appreciation for the content of a letter just received a day or two ago from Robert E. Gordon (and I am returning to the middle of p. 4), editor of my hometown paper, the Evening Republic of Columbus, Ind., in which Mr. Gordon asks for my impressions as to the outlook for American agriculture under the Kennedy administration. He makes the clear statement that "our farmer friends in southern Indiana continue to be disgruntled, but they are still opposed to sweeping governmental controls. They want help but they still want their freedom." Then Mr. Gordon adds, "The Columbus area is now in its worst business slump in many years, but we are looking forward to improvement by midyear." My hometown area is no longer dominated incomewise by agriculture, having as it does a very substantial industrial complexion. Even so, prolonged agricultural distress and low rural purchasing power is a very clear and definite factor in the background of Mr. Gordon's statement above.

I need not remind the members of this committee of this fact, but all of us need constantly to endeavor to have all of our fellow Americans understand this, so that the prospect of intelligent decisions and innovations may be brightened, and the improvements in the broad economic balance in our whole American structure may be hastened. It is not necessary that American farmers be forced to make a choice between a full free market such as no other segment of the American economy confronts on the one hand, or sweeping governmental controls of the type that may be envisioned in the above statement on the other.

I should like to say that not because we expect this committee to assume a leadership role in having us to draft a reasonable, and what I should call an American type of farm policy, but because we do feel that you ought to have the opportunity of making up your mind whether the programs that we advocate are in conformity with the principles in which we believe, and in which you believe. We have inserted in this testimony the recommendations that we made to the Secretary of Agriculture in the Thomas Jefferson Auditorium in the South Building on January 26.

Now, these are, as I have stated, declarations of general policy. We are prepared to interpret them to any extent that this committee may want them interpreted for your information.

I should like now to read the final paragraph on page 10 and I think that will conclude my statement with the remainder. If we overemphasize efficiency—perhaps I should say first of all that this remark is dictated by the language in section 2 of appendix B on page 93 of the President's Economic Report, and with reference to those statements that are there, wherein he attempts to differentiate, as my colleague, Mr. Hamilton, has done to some extent, between the commercial part of agriculture as President Eisenhower referred to it and the noncommercial holdings—I want only to point out that if we overemphasize efficiency (in terms of the lowest possible cost) and ignore the consequences of some aspects of the type of vertical integration that substantially reduces individual opportunity for large numbers of Americans, and which in some cases is predicated on unrealistic wage and working conditions, and if we at the same time fail to place appropriate value on the sound economic as well as social aspects of seeking only such increase in the size of individual owner-operator—manager, or family units in American agriculture as will utilize all of the capacities, and abilities of that family efficiently, then we may be unwittingly destroying the very foundation for the magnificent agricultural efficiency pattern which has characterized agriculture in our generation. At the same time we may be laying the groundwork for substantially higher food and fiber cost to all Americans in the not too distant future.

If all Americans can be induced to clearly understand the potential of these alternate courses and objectives, then a very substantial majority of them will surely join with us in seeking the sort of agricultural pattern that dictated our recommendations to the Secretary on January 26. Our American kind of capitalism—predicated on individual opportunity for the many rather than for the few—can and will be the pattern which attracts the people of the world, only if we prevent erosion of those opportunities.

The CHAIRMAN. Thank you.

(The statement referred to follows:)

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE

The privilege of presenting our viewpoint from a strictly rural and agricultural perspective, and from a lay point of view—on the subject matter of the President's Economic Report—to this committee annually is much appreciated.

The time has long past, if indeed it ever was, when as farmers and rural American families we can afford to ignore, or be unconcerned with, decisions that are made or recommendations that are advanced in compliance with the provisions of the Employment Act of 1946. Indeed, it is our plea to the members of this committee, that each of you keep in mind the fundamental fact that decisions with respect to nonagricultural industry and nonagricultural labor, as well as those with respect to the monetary and fiscal policies of America, and all related subject matter which comes under the scope of the President's Economic Report, are of vast importance to all of us.

If we may somehow cultivate a universal appreciation of the fact that one man's price or wage in this great interdependent American economy of ours immediately becomes another man's cost we will be well on our way toward understanding the basic foundation of the so-called farm problem that has confronted us for many years.

There is great significance in the fact that agricultural indebtedness has continued to increase over the past several years, and that the increase during 1960 brought us to a level of approximately 13 percent of all assets—leaving an equity in our agricultural balance sheet of some 3 percent less than it was 12 months ago. This increase in debt has developed in spite of the fact that American agriculture has continued its miraculous and steady improvement in efficiency.

The productive capacity of American agriculture clearly makes a contribution to the general national welfare—to the total American economy, which should be the basis for an equitable rate of reward on investment and labor, in comparison to that rate of reward enjoyed by other segments of the American structure, and in relation to the productive output, or contribution to the general welfare.

A year ago we pointed out to this committee that "we are distressed and impatient that our own vital segment of the economy—the rural segment—is distressed and obviously has prospect of even greater depression." We further stated that "it seems apparent 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 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 would like here again to emphasize that we in agriculture clearly recognize that our great American industrial structure owes much of its stature and development to the fact that Alexander Hamilton, as long ago as 1789, declared that within the framework of a pure unrestrained democracy and under a system of complete and academically free competition there could be no substantial economic and industrial progress in America; and to the fact that Hamilton won in his debates in his head-on clash and conflict with Thomas Jefferson in this particular subject matter. American industrial development, as we have known it, would not have been possible without Hamilton's victory.

We want here to reaffirm our appreciation of the great contribution to our total American economy that has been made under legislation that provides industrial laborers with opportunity through collective bargaining and other governmentally secured mechanisms, the power to raise their wage and income levels and increase their purchasing power. Without this second leg (on what I might refer to in my farm parlance as America's economic milkstool) it would never have been possible to have had the growing and expanding market for American industrial and agricultural output that has characterized our economy during the past two and one-half decades.

Of course, the economic and political power of American business and of American labor has generated the necessity of restraint and discipline—in some cases enforced. We have been proud of our organization, for the battles that have been waged and won, to restrain the strong, to regulate monopoly, and to preserve the fundamentals of competition—within the framework of reasonable governmental regulation. We shall endeavor to continue to adhere to these principles in order that individual opportunity be extended to all Americans in proportion to their skill and efficiency and their will to work and produce—that they may be rewarded in proportion to their contribution to the general welfare.

This concept must include American agriculture and our rural families to a far greater extent than does the concept now embrace those Americans.

In a recent letter from Robert E. Gordon, editor of my hometown paper, the Evening Republican, of Columbus, Ind., in which Mr. Gordon asks for my impressions as to the outlook for American agriculture under the Kennedy administration, he makes the clear statement that "our farmer friends in southern Indiana continue to be disgruntled, but they are still opposed to sweeping Government controls. They want help, but they still want their freedom. * * *"

Then Mr. Gordon adds, "The Columbus area is now in its worst business slump in many years, but we are looking forward to improvement by midyear."

My hometown area is no longer dominated, incomewise, by agriculture, having as it does very substantial industrial complexion. Even so, prolonged agricultural distress and low rural purchasing power is a very clear and definite factor in the background for Mr. Gordon's statement above.

I need not remind the members of this committee of this fact, but all of us need constantly to endeavor to have all of our fellow Americans to understand this fact, so that the prospect of intelligent decisions and innovations may be brightened and improvements in the broad economic balance in our whole American economic structure may be hastened.

It is not necessary that American farmers be forced to make a choice between a full free market concept (such as no other segment of the American economy confronts) on the one hand, or sweeping governmental controls of the type that may have been envisioned in the above statement from my hometown editor. The products of the legislative structure under which American workers have gained economic progress have not been a choice of this sort. Nor is the degree of market management as practiced in American industry in either of these extreme categories. It is, of course, necessary that the principles which dictated the antitrust laws, those which dictated the creation of the Interstate Commerce Committee and the Federal Communications Commission as well as the Federal Trade Commission—namely the principle of preserving reasonable competition in order that opportunity for economic progress may be afforded to vast numbers of Americans, on the one hand, and in order that all Americans might, on the other hand, be protected from exploitation as a result of monopoly and restraint of competition—be clearly adhered to.

Of course, we in agriculture must recognize that quotas, import duties, excise taxes, and even collective bargaining (limited as it must be to a basic workweek of a somewhat limited number of hours) along with other wage stabilizing instruments and mechanisms, are clearly a definite part of our economic and political structure. We must ask those outside of agriculture, however, to recognize that these provisions in law in themselves give impetus to our rising cost levels in agriculture. It is inevitable, then, that we must develop somewhat comparable instruments and devices to secure an American, or parity of income level for the agricultural segment of our economy.

With this in mind, I incorporate in this testimony the outline of our recommendations to the Secretary of Agriculture under date of January 26, 1961.

Objectives and goals of governmental policies, with respect to American agriculture should be to—

(1) *Obtain parity income for producers.*—We emphasize parity of income—rather than parity prices. Parity income should provide a return—for their labor, management, risk, and investment—in reasonable relation to that returned for these factors in other segments of the economy.

(2) *Obtain income for farmers from the users of farm products—not from the taxpayers.*—Americans have both a moral and economic obligation to pay an American price for American farm products, the same as other segments of our economy receive an American price for their goods and services. Neither the farmers nor the taxpayers should be called upon to "subsidize" the consumers' market basket.

(3) *Encourage abundant production.*—

(*a*) to meet domestic requirements,

(*b*) to provide an adequate reserve supply to protect against shortages and for purposes of national security,

(*c*) to meet export requirements, and

(*d*) to facilitate our Nation's foreign policy and meet other international commitments.

Food and fibers must always be produced in abundance to guard against shortages and to meet other national requirements. This reserve or additional supply, should not, however, be permitted to depress prices, or set the price of the total production, as it would do under ordinarily demand-supply relationships. When this happens, producers are actually subsidizing those who use their products.

(4) *Increase producer bargaining power.*—The great difference in economic organization between agriculture and industry generally is that industry is organized to manage its production and marketing, to operate profitably on the basis of costs, even when operating at less than full capacity.

Farmers are not similarly organized. They have virtually no voice in determining the value or selling price of their products. They do not have the bargaining power to pass along in price their production and marketing costs or to obtain a fair return on capital and management. This weak bargaining position has made farmers defenseless against rising costs and resulted in a sharp decline in net farm income. The Grange's domestic parity concept is aimed at giving farmers the means of enhancing their bargaining power comparable to that enjoyed by labor and business.

This would be accomplished by enabling farmers, acting together through various legislative devices, to exercise greater control and management over supplies and marketings.

(5) *Provide greater self-help opportunities.*—Through the use of producer-managed supply, marketing, and export programs to provide farmers with the framework for orderly marketing and market expansion tools, financed, controlled, and operated by producers;

(6) Develop effective resource control measures to reduce the amount of land in production and balance productive capacity with market demands; and to reduce excessive carryover stocks; and

(7) *Expand agricultural exports.*—

Through programs which would facilitate producers' opportunity to compete for and gain access to world markets:

Through measures designed to eliminate trade barriers anad other restrictive devices which discriminate against the United States;

Through measures to encourage economic development in underdeveloped areas consistent with the development and maintenance of export markets for U.S. agricultural products.

With parity of income to agricultural producers, as outlined in section (1) above, as the objective toward which all programs and policies should be coordinated and directed, the various measures outlined above would be developed on a commodity-by-commodity basis and be adjusted or modified from time to time, in terms of the rate of progress toward such objectives.

In like manner, it is crystal clear that an acceptable yardstick for determining the extent to which producer-bargaining power may legitimately be used—and the point at which discipline must be applied in its use—would be established.

Short-term measures of both legislative and administrative character, embracing methods of utilizing existing governmental stocks of agricultural commodities (and any other excessive carryover) in the interest of sound domestic and international purposes and objectives, are capable of development; both for the purpose of meeting emergency needs, and in terms of hastening the day when a soundly designed series of commodity programs (along the lines outlined above) can be made to function—with increasing effect in achieving equitable agricultural income. Such short-term measures should undoubtedly include a sound land-use program in combination with some measure of payments in kind as a means of regulating production during this period of reduction of excessive carryover.

Long-term programs must clearly put major emphasis on a marketing (and management of available supplies according to end use and primary market requirements) philosophy; in order to increase the bargaining power of farmers.

Such increased bargaining power is entirely compatible with our American capitalistic system, which has, with reasonable consistency, been dedicated to the principle that opportunity, to achieve reasonable economic progress, shall be extended to all people—through a system of "proper equality, equity, and fairness; protection for the weak; restraint upon the strong; in short, justly distributed burdens and justly distributed power. These are American ideas, the very essence of American independence, and to advocate the contrary is unworthy of the sons and daughters of an American Republic." (Quote is from the Declaration of Purposes of the Grange, adopted in 1874.)

The implications of such programs in relation to all Americans are of tremendous importance because properly conceived, designed, and administered, they would—

(1) Raise net farm income to a level compatible to that of other Americans.

(2) Assure consumers of an abundant supply of food and fiber at fair prices and at the same time reduce governmental farm program costs.

(3) Restore to private trade the handling and sale of farm products—and stop U.S. promotion of state trading.

(4) Permit competitive sales in world commerce without taxpayer subsidy.

(5) Allow competitive efficiency—instead of Government controls—to determine farm production patterns.

(6) Retain for producers the responsibility for the control of surpluses.

(7) Assure farm operators a maximum degree of freedom in the management of their own business.

(8) Permit price to serve its proper functions in the marketplace.

CONCLUSION

In our modern-American economic structure, one man's price or wage becomes another man's cost of doing business or cost of living.

Protective economic devices, beginning from the very birth of our democratic Republic, have made great contributions to the evolution of the industrial might of America, though it has been our responsibility, as Americans, to consistently try to keep these devices in balance with respect to the best interest of all Americans, as well as with respect to the competitive effect on American industry.

In more recent times, it has been deemed wise and proper, through collective bargaining, fair labor standards, and other mechanisms and practices, to raise the living standard, and the purchasing power, of Americans though it has been necessary here too, that we demand (or where need be, impose) discipline in the national interest.

It should be clearly apparent to all who would study our total American structure, that it is now necessary that we recognize, within our complex American type of capitalistic structure, that in an industry as complex as modern agriculture, the development of commodity programs encompassing principles enunciated above will serve both America as a whole, and her agricultural economy, well.

Much progress had been made in this direction. Marketing orders and agreements, the Sugar Act of 1936, and the Wool Act of 1954 are in conformity with our Grange domestic parity concept. It will, very properly, take time, and invite controversy, as we apply the lessons of experience in further developing this concept. Indeed, there are some commodities, wherein we are not certain yet as to the necessary mechanics and devices to carry out the concept.

We believe, strongly, however, that the concept provides a blueprint for building such an array of effective commodity programs—programs under which farmers and rural America can become a legitimate part of—and indeed a contributor to—an increasingly great and dynamic America.

We further believe that such an America can and must have major influence on the course of history of the entire world as we work toward the objective of consistently moving in the direction of the wisest sort of worldwide allocation of resources in terms of nutritional, economic, and other needs of the world's people as well as in terms of equity among Americans.

The above statement is incorporated into this testimony, not to imply that we expect this committee to chart the course for such a farm program as we in the Grange have advocated, but in order that we may offer this committee evidence that we are trying diligently to chart an agricultural course, which is reasonably consistent with the American structure in which we live and operate, and in which we seek to preserve and expand opportunities for all Americans.

In noting the content of section II of appendix B as found on pages 93–106 of the economic report of the President as transmitted to the Congress on January 18, 1961, I should like to join the President in recognition of the difference between what he refers to as the "commercial part of agriculture" and what he referred to, on the other hand, as the "noncommercial holdings, many of which are little more than farm living units." On the other hand, I would call the attention of the members of this committee to another fundamental fact.

If we overemphasize "efficiency" in terms of the lowest possible cost and ignore the consequences of some aspects of the type vertical integration that substantially reduces individual opportunity for large numbers of Americans, and which in some cases is predicated on unrealistic wage and working conditions; and if we at the same time fail to place appropriate value on the sound economic as well as social aspects of seeking only such increase in the size of individual owner-manager-operator or family units, in American agriculture, then we may unwittingly be destroying the very foundation for the magnificent agricultural efficiency pattern which has characterized agriculture in our generation, and at the same time may be laying the groundwork for substantially higher food and fiber costs to all Americans in the not too distant future.

If all Americans can be induced to clearly understand the potential of these alternate courses and objectives, then a very substantial majority of them will surely join with us in seeking the sort of agricultural pattern that dictated our recommendations to the Secretary of Agriculture on January 26.

Our American kind of capitalism, predicated on individual opportunity for the many rather than for the few, can and will be the pattern which attracts the people of the world only if we prevent erosion of those opportunities.

Senator DOUGLAS. Mr. Hamilton, I would like to raise a point about one of your statements in which you say:

> Recent discussion of farm problems has tended to obscure the fact that farmers have been hurt more by rising costs than by falling prices.

Now, do you have a copy of the January 1961 Indicator near you?

Mr. HAMILTON. Yes, sir.

Senator DOUGLAS. If you will take 1952 as the base, which is a relatively good year, you will find that the index of prices received by farmers in that year was 288, that on December 15 of 1960 the index of price received by the farmers for all farm products was 242. This was a decline of 46 points, and, if I can divide, of 16 percent approximately.

On the other hand, take the price paid by farmers, you will find in 1952 that index was 287. On December 15, 298, or an increase of 11 points or a little over 4 percent. So that you have a fall in prices received by farmers of 16 percent, an increase in prices paid by farmers of a little over 4 percent. This is what caused the decrease in the parity ratio to 81 percent.

According to this figure the fall in prices received by farmers was approximately four times as great as the increase in the prices paid by farmers. Now, I think my figures are accurate, are they not? First, are the figures accurate?

Mr. HAMILTON. I have given correct figures. We all use pretty much the same figures. The point you are leaving out, Senator, is the question of volume. A good part of the decline in farm prices has been offset by larger volume. I gave you the figures here on gross income and I believe they are also in Economic Indicators. They certainly are in the Economic Report.

Senator DOUGLAS. Yes, sir.

Mr. HAMILTON. As I pointed out, the gross has gone up. Another thing is that you are using 1952——

Senator DOUGLAS. Very slightly, in 1952, $37 billion. In the third quarter of 1960, $38.1. An increase of about 3 percent.

Mr. HAMILTON. You can get a basis for different statements by taking different bases for comparison. I started with 1947 in my statement. I did that simply for the reason that 1947 was the all-time high in net farm income.

Now, I am not prepared to argue that 1947 was not an unusual year. I merely say that it was the all-time high year for net farm income. Starting with 1947 as a base there has been more decline due to rising costs than to falling prices.

Senator DOUGLAS. Now, there is one point that I would like to make. That is that some of the components of rising costs, are they not, in large part machinery and fertilizer and not merely hired labor and not merely food products consumed by the farmer?

Mr. HAMILTON. Certainly. I haven't checked the relationship lately, but I would think that higher labor costs on the farm are a relatively minor factor in the total picture simply because many farmers do not employ labor.

Senator DOUGLAS. That is just the point I want to make. Has not the increase in quantity largely been obtained by increased use of capital in the form of fertilizer and machinery and while it is true that an increased quantity of these products are needed, isn't it also true that the increased prices of these articles have contributed in large measure to the increase in cost, hence to the decline in net income?

Mr. HAMILTON. There are two factors. One is the higher prices paid for off-farm inputs and the other is that there has been a greater use of purchased inputs. Getting back to the question of base, of course farm prices were relatively favorable in 1952 as compared with some other years on both sides of 1952 because of the Korean situation.

Senator DOUGLAS. There have been quarrels about the base and so forth, but the point I want to make is that the decline in farm prices has been more severe than the increase in the index for goods purchased by farmers. I think that is true. Much more severe.

Mr. HAMILTON. Since 1952.

Senator DOUGLAS. This index that I have does not go back to 1947. I am not quite certain what the 1947 figures will show. We can have those put in the record. That is the point I want to make.

Gross farm income and production expenses of farm operators, selected years

[Millions of dollars]

	Gross farm income	Production expenses of farm operators										
		Feed purchased	Livestock purchased	Fertilizer and lime	Repairs and operation of farm capital items	Depreciation on buildings and equipment	Hired labor	Taxes levied	Farm mortgage interest	Rent	Other	Total
1947	34,352	3,746	1,379	755	2,401	1,604	2,810	733	225	1,455	1,940	17,048
1952	37,016	4,331	1,917	1,229	3,433	3,399	2,802	1,038	319	1,421	2,711	22,600
1959	37,467	4,623	2,727	1,444	4,087	4,125	2,929	1,445	580	1,001	3,198	26,159
1960	37,900	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	26,300

[1] Not available.

The second point I want to make is that while you are quite correct in saying that the total income of farmers has either been maintained or very slightly increased because of the increase in volume, the increase in volume has, itself, necessitated an increased use of capital, more fertilizer per acre, more farm machinery per farm. Sometimes the indication which is given that there has been an increase in cost, which, as a matter of fact, has been less than the fall in prices, due solely to an increase in wage rates.

I think that perhaps you and Mr. McDonald furnish interesting counterfoils for each other. Mr. McDonald is pointing to administered, and in a sense monopoly prices of goods which farmers purchase, either chemicals or machinery. But sometimes, and I don't know that you do it in this paper, but sometimes your organization seems to talk as though the chief cause for the decline in farm income was the increase in wage rates, whereas it has been caused, first, by a sharp fall in farm prices even though that has been compensated by, perhaps, and in part caused, by the increase in quantity.

Second, that, after all, the major production expense of a farmer consists of capital now rather than labor. Certainly, on the smaller farms this is true. And it is necessary to use more capital per unit of product than before, both in fertilizer and in machinery. I think that is true, is it not, Mr. Newsom?

Mr. NEWSOM. That is right.

Senator DOUGLAS. Then, if you break up the price index of the commodities purchased by farmers, I think you will find that the sharpest increase has been in these respective fields.

Now, you may say that increases in wages may play a real part in increasing the prices of products, but certainly this is not the whole story in view of the evidence that Mr. McDonald produces. What would you say about this extraordinary degree of agreement in a supposedly competitive bidding which Mr. McDonald shows in his report. Take, for instance, that illustration on page 2 that he pointed out—cement. The farmers use cement. Here is a delivery point out in California and the suppliers were at different places, Los Angeles, San Francisco, and Oakland, quite a distance between them. Yet their prices were identical to the last cent, $3,888.64.

Now, could that have been purely accidental? Isn't the whole theory of probability such that probably this could occur only once in 10 to the 10th power times which, if my memory is correct, is one out of 10 billion times. Doesn't this indicate an area of agreement between firms to keep prices up?

The CHAIRMAN. It could be based on the terms of a conversational agreement.

Mr. HAMILTON. I think this certainly indicates some kind of connivance. My second point would be that the Justice Department ought to investigate to determine whether the identical bids reflect agreement among the bidders or some prearrangement with the people that asked for the bids. This has happened. Sometimes the price is worked out by conference with the purchasing agency, and the business is divided among those who bid, I understand. But if there were actual connivance between the cementmakers the Justice Department should file antitrust proceedings, and give them the treatment they gave the electrical companies recently.

Senator DOUGLAS. I would like to see your organization stress this point a little more than it does. If they did I think the farm groups could get together a little bit more than they have because the representatives of the Farmers Union, and the Grange have stressed these points. I may not have been observant, but I have not noticed that your organization has stressed it very much. If this is an occasion that your organization feels very acutely on this point, perhaps we may be getting a degree of agreement between these organizations which the Secretary of Agriculture did not obtain a couple of weeks ago.

Mr. HAMILTON. Senator, we are very strong in support of an effective antitrust policy.

Senator DOUGLAS. Good.

Mr. HAMILTON. We do not favor this kind of shenanigans, as I would call identical bids. We think the Justice Department should investigate this kind of bidding and if the facts prove to be as they appear here, they should file an antitrust suit as the previous administration did in the electrical equipment case.

Senator DOUGLAS. Would you back them up if they did?

Mr. HAMILTON. Certainly.

Senator DOUGLAS. Would you stress this in your talk to the farmers about how these fixed and administered prices are hurting the Nation?

I don't cover the waterfront. I must admit I have not seen all your releases, but I have never seen this issue greatly stressed by your organization.

Mr. HAMILTON. We have stressed our support for an effective antitrust program. I might say though in regard to cement that, while it is amazing that these bids are identical, you would expect the bids to be a little closer together on a commodity like cement which is not susceptible to brand preferences than on some other commodities. You would expect them to be rather close; however, identical bids indicate some kind of agreement.

Senator DOUGLAS. That indicates that the basing point system is really operating.

Now, look at the other sheets that Mr. McDonald presented. Let us go to page 5 and look at paper cups. I don't know how many paper cups farmers buy, but that is an item. Here were eight suppliers. They furnished identical terms, 2 percent off, 10-day payment, coming to identical prices, $6.18. That is somewhat strange, isn't it?

Take polio vaccine; I think this is something that Senator Kefauver would love to take up. But take polio vaccine. Listen to this: The unit price for a vial from the Pitman-Moore, the Eli Lilly & Co., Merck, Sharp & Dohme, Parke, Davis & Co., Sisson Drug, 3.9592, which makes it even more remarkable because you are comparing it to four points. Here they are correct to four decimal points. That is correct to four decimal points. Now, could this be accidental? I would say that if the degree of agreement in the other case, being purely accidentally, would be one out of 10 billion, this I would estimate to be equivalent to about one out of 10 quintillion.

Mr. HAMILTON. Senator, I would say that these polio vaccine bids could not be accidental. I would say the bids on paper cups could be accidental on a commodity that is rather uniform and where brand makes——

Senator DOUGLAS. Even though the shipping points are different? You see, that is the point. The shipping points are different. Therefore, the actual freight charges would be different. These are delivered prices.

Mr. HAMILTON. I believe in a purely competitive situation where everybody has complete information and commodities are of a uniform type, prices tend to a common level. You would not pay $6.20 for cups if you could get them for $6.18.

Senator DOUGLAS. This is the common defense that is given, but let me ask you this: When prices change, do they straddle or, in these industries, do they move with the precision of an infantry company in a free society so to speak where people are not under military discipline? When people cross a street on red lights and green lights they straggle. One man will lead off, and so forth. But a military company moves with precision, all stepping off together. There is a common principle, common order.

Now, what we tend to find in these cases is that not only will prices be uniform at any time, but when they change they all change at once and to exactly the same degree.

The CHAIRMAN. Will you yield to me?

Senator DOUGLAS. Yes; certainly.

The CHAIRMAN. Mr. McDonald, I believe you stated there were about 10,000 cases as this kind in the Department of Justice; is that right?

Mr. MCDONALD. As I recall, Professor Mund had in his article 10,000.

The CHAIRMAN. Anyway, there is a large number. I wonder if it would be in order, either by law or regulation, or some way, to require the Department of Justice to make a report, to make a public report of all these bids. Would that be helpful?

Mr. MCDONALD. Yes, sir.

The CHAIRMAN. As it is now, these bids are not subject to public inspection, or they can be seen only with great difficulty; is that right?

Mr. McDONALD. I am not familiar with that, Mr. Chairman, as to whether anyone can go down there and look at this material.

The CHAIRMAN. It is an impossible job for the ordinary citizen. I know that because I have gone into the matter several times over the past year.

Mr. McDONALD. I do know that much of this material is open to inspection. I have inspected material in the Federal Trade Commission many times.

The CHAIRMAN. But you would have an awful time putting together all this information about identical bids.

Mr. McDONALD. Yes, sir.

The CHAIRMAN. If we could require a report to be made outlining these situations, I think it would be well. This would bring to the attention of all the Members of the House and Senate specific identical bids and it would make the information available to the public generally.

Don't you think that would be a good idea?

Mr. McDONALD. Yes, sir.

Senator DOUGLAS. That is an excellent idea, Mr. Chairman. I want to say that if the line that is implied by Mr. Hamilton is followed up by the organization which he represents in a research capacity, I think we have the beginning of a common farm program, namely, an attempt to reduce monopoly prices on commodities which farmers buy.

Mr. HAMILTON. Senator, I will be glad to offer for the record a copy of our resolution on monopoly which is a really complete one.

Senator DOUGLAS. Resolutions are one thing. Acts are another. I think it was Samuel Johnson who said, "Words are the daughters of earth, and that things are the sons of heaven." I don't mean to imply that sons are necessarily better than daughters. But the test is not in resolutions, but in actions.

The CHAIRMAN. I wish all the farm organizations could get specific on this. This can be broken up, no question about it, because triple damages will apply here.

Whenever you prove a certain amount, a thousand dollars damage, the court will automatically give you $3,000.

Senator SPARKMAN. Referring to that suit that was filed yesterday in Peoria, it might be well for some groups representing farmers to start some of these consumer suits for triple damages.

Senator DOUGLAS. I think there is great possibility here that the chairman call a conference of the major farm organizations just as the Secretary of Agriculture called a conference on farm income he could call a conference on farm expenditures and if you can get all three of the farm organizations working together on this, then this may be the beginning of a new and happy life together.

Mr. HAMILTON. Senator, I would like to say that our record is a lot clearer than your statement indicates. We not only have a strong position on antitrust enforcement; we are opposed to fair trade laws which certainly are price-fixing laws.

We are also opposed to the increased tariffs and quotas that affect costs.

There is in a case that is up right now—a proposal to put tariffs on binder and balers twine which have been on the free list for years and years.

We are opposed to such tariffs.

The CHAIRMAN. In opposing the fair trade laws, you are taking a side in opposition to the small business; but not doing anything about the illegal price-fixing schemes you are favoring big business.

Mr. HAMILTON. We have a position in favor of antitrust enforcement. We have supported antitrust legislation and appropriations for antitrust enforcement.

We are in favor of the Justice Department investigating the cases we have been discussing here.

Senator SPARKMAN. I would like to ask Mr. McDonald: Are these figures from the files of the Department of Justice?

Mr. McDONALD. Senator Sparkman, as I understand it, I got these figures out of an article published in the Journal of Political Economy, I believe it is, of April 1960.

Professor Mund stated in his article that the law stated that when the General Services Administration in looking over these bids and these prices thought that any of them were collusive or possible violations of the antitrust laws that it was directed to refer them to the Department of Justice.

These figures I presume prove Professor Mund took from the Department of Justice files. In fact, he so states in effect in his article.

Senator SPARKMAN. Mr. Chairman, I am impressed with many of these figures. Now, in the case of the electric companies, and there have been antitrust suits against the cement companies, I believe, based upon identical bids of this kind, I don't see why there should not be as much interest shown in things pertaining to articles that farmers have to buy.

I would like to suggest that this committee have its staff dig into this a little further and let us find out what the facts are and let us ask the Antitrust Division of the Department of Justice what has been done, or what it contemplates doing.

This should be done because this might be a place where perhaps we could hammer down a little bit the cost of things that farmers have to buy, or at least give them a right to buy on an open, competitive market.

The CHAIRMAN. I wonder if the three farm organizations would be willing to participate in such a conference with the staff and the members, preliminary to taking some action in that respect.

Mr. McDONALD. The Farmers Union would be delighted to participate.

(The following was subsequently received for the record:)

AMERICAN FARM BUREAU FEDERATION,
Chicago, Ill., February 16, 1961.

Hon. WRIGHT PATMAN,
House of Representatives,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: In the course of the Joint Economic Committee hearing held on Friday, February 10, 1961, you raised a question relative to the willingness of the three farm organizations to participate in a conference on such matters as administered prices and identical bids on Government contracts. From a reading of the transcript, it appears that the subject was changed before

I had an opportunity to answer this question. I want to assure you that the American Farm Bureau Federation would be happy to participate in such a conference.

Sincerely yours,

W. E. HAMILTON, *Director of Research.*

Mr. NEWSOM. Mr. Chairman, might I say that lest I might be misinterpreted as feeling neglected, I have hesitated to barge in here because I am sure that nothing needs to be said to strengthen the record of the Grange down through almost a hundred years of experience in fighting monopoly and bringing utilities under regulations in the public interest and all that sort of thing.

I would like to suggest that we might supplement the comment of Senator Sparkman by making some study of whether or not the very extensive work that was being conducted by the Federal Trade Commission under Earl Kintner is to be continued under the new leadership of that Commission.

Now, we have had a great deal of interest in this. There are evidences of restraint of competition, not only in the commodities that we buy as farmers, but in the sales and distributive processes.

Over the past 3 or 4 years under Earl Kintner's chairmanship we have been delighted with the increasing emphasis on this phase of activity.

It was really, I don't know that it is appropriate at this time, but it was really a source of great concern to us that there was no effective leadership taken to confirm Mr. Kintner's appointment, to the chairmanship of the Federal Trade Commission.

I have frankly a great deal more faith and confidence in this particular agency, at least in the initial stages of getting evidence and facts here, than I do in simply going and relying directly on the Department of Justice.

Now, perhaps it is entirely appropriate and I welcome the suggestion of both the chairman and of Senator Sparkman here because I think this is a very profitable area for all of us to explore.

The CHAIRMAN. You would cooperate in it?

Mr. NEWSOM. Every bit of the way.

The CHAIRMAN. Will you yield just for a suggestion?

Senator SPARKMAN. Yes.

The CHAIRMAN. May I suggest that under this new administration you are going to have two of the best men in the United States on the Federal Trade Commission, Mr. Dixon, and Mr. McIntyre. Mr. Dixon's name has already been sent up, and President Kennedy announced the other day that the next vacancy will go to Mr. McIntyre. Those two gentlemen, I believe, are as good as you can find in the entire United States.

I think the Federal Trade Commission will become more meaningful than it has ever been in the past under the leadership of those two men.

Mr. NEWSOM. I am delighted to hear it.

Senator SPARKMAN. I agree with the statement that the chairman has made. Certainly a new Chairman, I think, can be depended upon to be quite aggressive in his desire to carry out the intended functions of the Federal Trade Commission, which is to lend just this kind of protection, to dig out the facts.

I think certainly it can be depended upon to do it.

By the way, I should like to say that I felt Mr. Kintner did a very good job while he was in there along this line. I am delighted to hear the sentiment expressed by all of you.

I may just say, Mr. Chairman, you are chairman of the Small Business Committee of the House, I am your counterpart in the Senate. You and I know that in spite of all the words that are said about small business in reference to getting contracts and in reference to management and loans and all of that, the real problem affecting small business in this country is that same thing.

The CHAIRMAN. Certainly.

Senator SPARKMAN. The farmer and the small businessman find themselves in the same box on this thing. I think it is something that we should follow.

Mr. McDonald, I am delighted you brought these figures out. I am delighted to hear the discussion on the part of the others.

I was going to ask if the Department of Justice had started action on any of these particular cases? Do you know?

Mr. McDONALD. As far as I know, they have not. I assume that there was such a multitude of sinners, they picked out only a few of the biggest ones.

May I comment for a moment on this?

Senator SPARKMAN. Yes.

Mr. McDONALD. I should first like to call attention to another table which Professor Mund has in his article, examples of competitive bidding.

Now, it is argued that in instances where prices are identical that you have companies coming together and pretty soon everybody knows the price of a certain article is going to be XYZ.

So you have the common price.

What these people don't point out is that the price stays that way over a period of years. Usually if it changes it goes up and as the chairman stated, they all go in step.

I think the figures in table 2 are equally significant. There is a wide difference in the prices. If the members of the committee will glance through those prices, they will see that they differ very widely.

So it is not a natural thing for you to have just one price, one administered price.

Senator SPARKMAN. Of course, I think it is significant, but as I pointed out a few minutes ago, it seems to me the table below that is even more so where they agreed to four decimal points.

Now, I do not see how that could be accidental. Or the one above it where they agreed to three decimal points, five bids.

And the one down here, five bids to four decimal points.

Now, let me pass on to something else.

Mr. Hamilton, I want to ask you a brief question regarding your statement. That was in treating the surpluses you say we have 16 months carryover in wheat; is that right?

Mr. HAMILTON. Yes.

Senator SPARKMAN. You said we have about 6 months carryover on corn. Now, what do you consider a proper reserve?

I am just asking out of curiosity and for my own information. On corn, for instance?

Mr. HAMILTON. Well I would not be prepared to give a figure. Under the kind of program the Farm Bureau favors—which you have a flexible level of price supports and permit the support price to go up and down with changes in the situation—you don't have to worry about the size of the carryover because it will fluctuate with conditions.

This is somewhat as would happen on a free market.

Senator SPARKMAN. I am talking about how it would fit with the particular program.

I am just talking about it from the standpoint of general information because I often think that perhaps we overemphasize our surpluses.

I do not feel that a 6 months' supply of corn in reserve is a very heavy reserve. That came up in some of the testimony yesterday. One of the witnesses testified with reference to different crops. I remembered that I read in the paper the other day that our carryover in cotton estimated for August 1 of this year, which is the breaking date, was the lowest it had been since 1952. I think it was.

You remember in 1952 we had an embargo on cotton. It was so low that we could not ship cotton. We had it below the safe margin.

The amount of cotton carryover as of August 1 of this year is estimated to be about 7 million bales.

Now, I think you are getting to just about the breaking point of safe reserve when you get to that point in cotton. I am just wondering where that safe point is on corn.

I remember, too, back in 1951 or thereabouts when India had a famine and wanted to buy, I believe it was a million tons of wheat, from us. There was a great deal of protest throughout the country that we did not have enough wheat to sell them that wheat.

Now I suppose with 16 months carryover we certainly have it now. I am just wondering how much reserve we ought to count as a safe reserve for our own uses against a bad year or against a flood or famine. Do you have an idea?

Mr. HAMILTON. Senator, I believe in relatively low carryovers. We have a great productive capacity in this country. We have a widely dispersed geographical production area for most of our commodities. We are next door to another great surplus producing country. I do not think that you need to have large reserves in order to protect the public.

We have a livestock economy. The first thing that would happen if we were a little short of grain is that we would cut down on our feeding of livestock. Maybe we would speed up the slaughter of livestock. This would save grain which could be used for human consumption or export.

In a very short time we could increase production and end the shortage.

In order to have a serious shortage we would have to have a really tremendous disaster running over 3 or 4 years.

Senator SPARKMAN. Thank you.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. Mr. Chairman, I have a brief question for each of the members of the panel.

I would like to say to Mr. Hamilton that I have had my differences with the Farm Bureau, but I think I was very pleased with your presentation generally. I thought it was constructive and it was good to hear a presentation from the Farm Bureau in which you were interested in solving the farm problem by increasing farm income.

As I understand it, the heart of your proposal related to a limitation on acreage planted, limited production, so that you can limit surplus and eliminate the depressing overhanging effect that the surpluses have had on farm prices.

I thought that was a constructive and useful suggestion and I think it makes sense.

Now, I would like to ask you in connection with this, in your statement you point out that limiting this one factor of input that produces food is not efficient in the sense that you cannot reduce production by 5 percent by reducing acreage by 5 percent because experience has indicated the farmer just pours more input, more labor, more fertilizer, more insecticides, more equipment into the remaining acreage and he gets bigger production and I agree with you a thousand percent.

Why is the Farm Bureau so reluctant to consider quotas and leave it up to the farmers, give him greater freedom to work within his factor of input and to make sure that your production is limited to what you need.

In other words, provide a quota that would result in a reduction of 5 or 7 percent, if that is desirable.

Mr. HAMILTON. One of the first things that will happen with volume quotas is that you will soon have people showing up with overquota stocks. Then you will get pressure for some kind of a cutrate sales program to get rid of this accumulation.

Another thing that happens when you maintain the price and limit production, is that the right to grow this protected quantity acquires a capital value.

The price of your land goes up, or the price of your quota certificate goes up. This dilutes the effect of this kind of program.

Senator PROXMIRE. Why does it dilute it?

Mr. HAMILTON. Take the tobacco program. I understand that an acre of land that has a tobacco quota in some areas is worth $1,500 to $2,500 more than it would be if it did not have a quota.

Senator PROXMIRE. Let me interrupt at this point to say that we do grow tobacco in Wisconsin and in especially the district that I represented in the Wisconsin State Assembly.

This tobacco program is popular. In the referendum in our State. Our farmers voted 12 to 1 for it. It has worked magnificently.

These are farmers that believe in freedom, they want a self-help program to solve their dairy problems, but they like this tobacco program; it works.

Mr. HAMILTON. I will agree that the tobacco program has been popular. Once you get into one of these programs and get an additional capital value built into the land, it is very unlikely that the farmers would be in favor of reducing the capital value their land has acquired as a result of the program.

Even if you take the position that the quota program is the best that could be developed for tobacco, you run into great difficulties in applying this type of program to other commodities.

You have about a million or a million and a half acres in all types of tobacco. You can make a 10 or 20 or 30 percent cut in tobacco acreage and it does not affect other crops very much.

But, when you start talking about a 10 percent cut in corn, you are talking about diverting 8 million acres.

Senator PROXMIRE. I agree with that. I think you have to have cross-compliance. I think your analysis is very useful that way, too.

You cannot simply limit production in the basics and expect it to work when you have substitute crops which will simply absorb the additional land or labor.

Mr. HAMILTON. The sheer magnitude of the acreage you have to take out of production if you have controls on other crops makes cross-compliance a serious problem.

Senator PROXMIRE. You are suggesting taking the lands out of production.

I am suggesting quotas and let the farmer decide how he wants to use his land and labor.

Mr. HAMILTON. There are many things to consider, including the fact that we have a great interest in export markets and if you use quotas and raise the price in this country, you will have to pay larger export subsidies or reduce our exports.

Senator PROXMIRE. Now, if you do not increase the price, it seems to me either you have to have direct Government subsidy, which I think is political planning, although it has some merit, or you are not going to be able to increase farm income it seems to me.

It seems to me that it makes a lot of sense for the farmer to do what everybody else in this American economy does, and that is to get an adequate income from what he produces by selling at a fair price and not be on the taxpayers' back.

He does not like subsidies. I know your organization does not like it, either.

Congress does not like it. If we can somehow arrange a situation in which the farmer can get a fair price in the market places it seems to me that is the safe way to solve the problem.

Mr. HAMILTON. We are in agreement on objectives. The Farm Bureau is certainly for improving farm income and for getting better prices in the market place.

Now, we have proposed a program we think will get an adjustment in production and help to get these accumulated surpluses off our back.

Senator PROXMIRE. But you are afraid the price may go up?

Mr. HAMILTON. We are not afraid of the price going up. We are quite happy with the recent increase that has taken place in soybeans, for example.

But we want to get higher prices in the market and not by support because high supports create a number of interferences and problems that we think in the long run reduce farm income.

Senator PROXMIRE. Let me go on to something else. I have just one more question. That relates to the same kind of thing although not the same precise area that was explored by the previous Members of the Congress. This relates to why the Farm Bureau in their statements such as your statement does not show an interest in reducing the cost of money to the farmer.

I call your attention to the economic indicators on page 3. The most rapid and consistent rise of any type of income I can find is in personal interest income. It rose between 1951, the first year shown there, and 1960 from $11.2 billion to $27.6 billion, an increase of 150 percent.

That is a fantastic increase.

During this same period farm income dropped from $16 billion to $12.4 billion, a drop of 20 percent.

As we all know, a very sharp and tragic drop.

Now, here are two items of income which, if not within the control of the Government, are tremendously influenced by governmental policy. It is possible for the Federal Reserve Board and the Congress to greatly and sharply influence the course of interest rates. Of course, we all know what a tremendous impact that can have on farm income.

Now, as a member of the Farm Bureau Federation, why don't you express an interest in the cost of money, the cost of interest, in view of the fact that the farmer is a tremendous debtor. In view of the fact that the cost, as Senator Douglas brought out so well in his colloquy, the cost of capital has gone up greatly and the utilization of capital has gone up greatly, why doesn't it make sense for the Farm Bureau to make a crusade against high interest rates in behalf of reducing the cost to the farmer.

Mr. HAMILTON. There are several problems involved. The first is the question of the individual farmer. Now, we are for measures that will enable the farmer to get the lowest interest rate that is consistent with the cost of money and the risk involved.

We have supported the Farmers Home Administration. We have supported the cooperative farm credit system—the Federal land banks, PCA's and banks for cooperatives. Then there is another question which you raise as to the general cost of money.

I am talking of the farmer getting the lowest interest that is consistent with cost and risk. You are talking about the general level of interest rates, what the Federal Reserve can do, and so forth.

Senator PROXMIRE. Of course, these other interest rates you mention have to be pretty much connected to it. We have to adjust the relationship to the general cost of money or they get so unrealistic that we cannot continue with it.

Mr. HAMILTON. We have not stressed the idea that the Federal Reserve should make money cheap because we are fearful that this would be a cause of inflation.

Recently, the balance-of-payments problem has created another reason for not taking that approach.

Senator PROXMIRE. Let me interrupt for a minute to say I am not advocating cheap money either. And I have not. I have agreed with Senator Douglas and others that there are times when interests rates have been too low. But I say that we have had an enormously sharp increase in interest rates. We have had an artificial tightening of the money supply so that we have a ratio between the money supply and the gross national product that is tighter than it has been since Andrew Mellon was Secretary of the Treasury.

As a result there is an artificial attempt to push the interest rates up. I am not asking that they be made cheap. I am just asking that they be moderate and at a competitive level.

Mr. HAMILTON. Senator, of course, there is room for disagreement. Some of these things are matters of judgment. I do know though that during the depression and in the war period some of the relationships between the supply of money and other factors in the economy changed materially and in this postwar period we have been going back a little bit more toward what were formerly normal relationships.

In spite of the talk about high interest rates I believe that interest rates in the United States have been relatively low in comparison with other countries.

Senator PROXMIRE. But this is because risk is far less, Government more stable, capital more abundant than anywhere else in the world. Of course our interest rates have been historically lower. Mr. Hamilton, you have been patient and helpful. Again I commend you on the constructive tenor of your remarks. I think they were useful indeed. I am glad to see your very great farm organization, which is the biggest in my State and one of the biggest in the country, taking this attitude that we do have to limit production as you suggested through soil bank in order to improve farm income.

Mr. HAMILTON. Thank you, Senator.

Senator PROXMIRE. I would like to pass on briefly to Mr. McDonald. I want to join my colleagues here on the committee in commending you on this startling presentation. I think it is pretty devastating evidence. You cannot argue with these facts.

As you say, I am not sure that all of us on the committee got the point, but table 2 is very significant on page 5 as you drop down.

What that shows is that where bidding is competitive the savings as you say, are perfectly enormous. There is a difference in one case, for example, in Argonne gas, of $11 as the high bid and $4.50 is the low bid.

The savings here is perfectly tremendous. So it shows that by insisting on competitive bidding the benefits to the consumer, including the farmer, can be very great.

What I would like to ask you about however, is this:

The general tenor of your remarks, and, of course, I am sympathetic with them, but I am wondering if we are not tilting at windmills here. The fact is that when we went through the depression of the thirties one of the first things that Franklin Roosevelt did was to organize the NRA.

One of the purposes of the NRA was to try to stabilize prices, you might say fix prices, establish prices, in order to provide a basis for recovery.

Well, industry has done pretty well in fixing its prices. By controlling its production and limiting its production.

You, as I understand it, are advocating that the farmer get a greater degree of control over his production, and limit his production. If this is what agriculture wants, do you have any philosophical argument with permitting industry to do this provided there is a degree of flexibility in pricing and a degree of competition?

Mr. MCDONALD. Senator, I look at the American economy this way: Labor has their unions, their bargaining power, and I wish all the working people would organize.

Senator PROXMIRE. Do you object to this?

Mr. McDONALD. I approve of labor unions provided they don't turn into racketeering organizations like some the Congress has investigated.

Senator PROXMIRE. You approve of their limiting the supply of labor so that they can negotiate for higher wages and in effect, together with the management, fix wages throughout industry?

Mr. McDONALD. Yes, sir; but I think there is a public interest. I do not think, and this is getting a little far afield from your question, that a labor union has the right to paralyze transportation, for example, that affects millions and millions of people.

I do not favor complete, you might say, laissez faire freedom for labor unions any more than I favor complete freedom for corporations. I think regulation is necessary.

The corporate groups have their unions, their chambers of commerce, and their associations and so on that presumably get together and fix these prices in some way, by some understanding.

Now, the farmer is competitive. The farmer needs the help of the Government to give him bargaining power, too.

But just as your milk marketing orders in your State and other States are supervised by a governmental agency, I think that these programs of price support and others should be supervised by the Government.

I think that the farmer should vote, two-thirds majority is the general rule, and if the farmers don't want this so-called regimentation, why, then, one farmer more than one-third throws it out.

I see nothing against the free enterprise system in allowing farmers to get together in their government in an election, supervised by the Department of Agriculture and decide whether or not they want to limit their acreage.

As you pointed out, in many of these referendums there is an overwhelming majority of the farmers who vote for the so-called regimentation, which is not regimentation at all.

Senator PROXMIRE. Let me interrupt you to say that you do not feel this kind of thing, this opportunity for farmers to limit their production, would give you the same kind of monopoly control of the food or the production of food or at least the farm products that you argue against so eloquently in the case of labor with your devastating statistics on identical bids.

In other words, you are not saying that industry should not do this, but for the farmer they have to do it?

Mr. McDONALD. I think that these matters should be supervised by Government agencies, by the Congress, by the Secretary of Agriculture, and in regard to big business I think as long as big business behaves itself and is responsive to the public interest, the law of supply and demand, that big business should not be bothered.

But unfortunately in many, many industries they have abused their rights under our Government. I think when it comes to a point at least, I testified last year on a bill on this side, S. 215, which would require these corporations to give a 30-day notice of a price increase and let labor come in and let business people come in and farmers come in and present the facts and let it be publicized.

I think in all of these areas we are discussing, the public interest, and that includes agriculture, should be paramount.

Senator PROXMIRE. Thank you very much.

We have another witness. I apolizige for taking so long. I do want to ask Mr. Newsom just one question.

Your objectives are certainly excellent and I agree with you 100 percent. You want to, one, obtain parity income for producers;

Two, obtain income for farmers from the users of farm products—not from taxpayers, and I am delighted to see you state: "Encourage abundant production."

I think it is very necessary that the farm organizations emphasize that we are pleased with this and we should be careful that we don't put ourselves in a position where we are going to have a food shortage that is conceivable even though it seems inconceivable now.

It seems to me your two points 4 and 5 indicate how you would accomplish this.

One, increase producer bargaining power. And I take it you would do this by marketing orders, this kind of thing.

And, two, providing greater self-help opportunities.

I am afraid I have asked this question a little late and I know it takes a long time to expand this in detail, but I would appreciate it if you would give us a capsule picture of what you have in mind.

This is mighty encouraging and exactly the kind of thing we need.

Mr. NEWSOM. Mr. Chairman, I thank the Senator for this question. This is one that I welcome a great deal.

Let me first say with respect to a portion of your discourse with my colleague here that we would like to emphasize the fundamental difference between what we call reasonable regulation and control of production. There is a vast difference.

The difference is not all psychological, but there is an important psychological difference.

This is related to the statement to which you have referred, that we must produce abundance in agriculture but that we must not permit that abundance in a normal operation of supply-demand factor to destroy the price level on all commodities.

Now, this gets us to the heart of one of the difficulties or disagreements between ourselves and some of our contemporaries wherein we insist that even though you must have an overall broad pattern to which all commodity programs must conform, you do have to have separate devices and sets of mechanics for the various commodities because of the difference in end use, the difference in marketing patterns.

Marketing orders and agreements work beautifully in many of our commodities. You can't apply the normal kind of marketing order and agreement that fits citrus fruits, for example, to wheat. You can't do that even to potatoes, although I think there is a way that we can accomplish the same thing.

What I am trying to say is that if we achieve methods by which we can price commodities (and regulate marketings) largely on the basis of end use, and in primary markets, as we do in citrus so that we get a good price for choice citrus fruits in the primary market; and then we regulate the flow of the product into the secondary market (quantities into frozen concentrates or, if need be, even into feed mixtures at a very low price) then the consumer and the producer are both better off, because stabilized supplies are the result, at reasonably stable prices.

I am old enough too, Mr. Chairman, to remember some of the controversy back of the enactment of the Sugar Act of 1936. I am old enough to remember when sugar prices were at terrific levels at least for short periods.

There was objection to this kind of regulation of market, of import duties and of processing taxes. Yet the program worked so well that within a very short period of time we were able to roll back the excise taxes and the processing taxes.

The proof of the pudding is in the eating.

There has never been a time since, when either consumers have been gouged or producers have been at the mercy of a ruthless operation of supply and demand.

Now, the pattern is established if we will just look at the record, Senator.

Senator PROXMIRE. Thank you very much.

The CHAIRMAN. It occurs to me that there should be some effort to do something about these identical bids. I have an idea that we should have a conference with people like yourselves who are so greatly interested and perhaps with other groups, too.

Purchasers of goods and services by the Federal Government and the State and local governments will aggregate about $100 billion a year.

When you consider that identical bidding prevails on much of this, the cost must run into a considerable sum of money. This certainly will affect the farmers greatly, as it affects the pocketbooks of all taxpayers.

I have been considering a proposal that would make these identical bids subject to public inspection, and reporting and require that they be brought to the attention of the Department of Justice. Senator Proxmire, I wonder what you think of this?

I have in mind an amendment to the General Services Administration Act and to the Armed Services Procurement Act, which requires these bids to be submitted to the Department of Justice when the head of a procurement agency receiving these bids believes that there is evidence of an antitrust law violation.

These two acts require this reporting only when the head of an agency thinks the antitrust laws may have been violated.

We have no assurance that all of the important bids are reported. So I had in mind that we should do something in the direction of a bill which would require that all bids be reported to the Department of Justice, in every instance where two or more of the bids are identical.

Now, that should certainly embrace the Federal agencies which involve $53,300 million worth of purchases a year. And we should also require the States and counties and cities and political subdivisions that procure $43,900 million a year to do the same thing on the theory that there is a national interest here, because we want evidence, and if there is any evidence of violation of law locally, why, they should be interested in presenting it to the proper authorities for attention.

Do you think that would be worthy of consideration, Senator?

Senator PROXMIRE. I think the general idea is excellent. I certainly approve the application to the Federal Government.

As far as State and local governments are concerned, I would want to study it.

The CHAIRMAN. That is right, to see whether or not we should go so far as to require them. But we certainly should invite them to do it, because they are complaining all the time about it.

Sometimes they have bids down to the fifth decimal point there from a number of different concerns.

Anyway, we will give further consideration to that.

Thank you, gentlemen, very much. You have been very helpful. We appreciate it.

What you have said will be considered and will be printed.

It will be made available to every Member of the U.S. Congress, and to all the committees and to the public libraries of the country and to the economists and people who keep up with these proceedings, too, in addition.

So it will receive wide distribution.

I know they will be helped by your constructive suggestions and views.

We have another witness, Mr. Howard L. Stier, trustee, Federal Statistics Users' Conference.

Mr. STIER. Mr. Chairman, Mr. Lowry is here. May he sit up here in the event of questions?

The CHAIRMAN. Certainly, if you would like to have him up here, we will be glad to have him.

I know we speak for Congressman Bolling, chairman of the Statistics Subcommittee, when I say that your young and growing organization has done a great deal of excellent work in seeing that this country has the best economic intelligence possible.

An example is your current help in reviewing the Steigler report on the Government's price indexes which is now being considered by the subcommittee.

We are glad to have you, sir. We shall be glad to hear you.

STATEMENT OF HOWARD L. STIER, TRUSTEE, FEDERAL STATISTICS USERS' CONFERENCE, ACCOMPANIED BY ROYE L. LOWRY, EXECUTIVE SECRETARY

Mr. STIER. Thank you very much, sir.

The CHAIRMAN. You may proceed in your own way.

Mr. STIER. Thank you.

The CHAIRMAN. You have a statement, I assume, and if you have any exhibits or charts, you may insert them in the record in connection with your remarks.

Mr. STIER. Very good, sir. You have copies of our long-range report and of our statement. My name is Howard L. Stier. I am director, division of statistics of the National Canners' Association.

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 informed current decisions and plans for the future.

For the first time in several years the President's Economic Report directs specific attention to the need for better statistical information:

> * * * to facilitate private and governmental decisionmaking, forecasting, and action.

If we take the items mentioned in the President's Economic Report and add to them, the improvements proposed in the budget for 1962, we have a long and imposing list covering practically every area for which the Federal Government provides statistical information.

The Federal Statistics Users' Conference has prepared a comparison of the major needs for improvement taken from our long-range program, with the items that are reported in the budget and in the President's Economic Report. The attachment at the end of our statement here compares these item by item so that I think there you can get a quick comprehensive picture of the two comparisons.

We think this gives a rough and rather useful indication of nongovernmental user needs as compared with the public policy needs that are indicated in the Economic Report and in the 1962 budget.

I would like to compare this list with a list of some of the major needs for improvement taken from "A Long-Range Program for the Improvement of Federal Statistics" which the Federal Statistics Users' Conference prepared as a result of a year-long study of common user needs for statistical information. This comparison gives a rough and, we hope, useful indication of nongovernmental user needs as compared with public policy needs as set forth in the Economic Report and the budget. The order of items in each list has no significance.

There are many places in which the needs recognized for public policy purposes and those recognized by users are quite similar. In some areas the informational needs for public policy purposes are well defined while nongovernmental needs are not. For example, public policy needs for improvements in health and education statistics have been more clearly defined than the common needs of nongovernmental users.

On the other hand, there are some areas where user needs for information are much more clearly defined than are the public policy needs of the Federal Government.

For example, the Conference's survey of uses of Federal demographic statistics by members revealed a widely felt need for improved current information on population and household changes.

On only one point, the proposed expansion of weekly indicators, does the FSUC report differ markedly from the needs for statistical improvement as expressed in the Economic Report and the budget. Users would put a relatively low priority to the development of additional weekly indicators beyond the proposed weekly series on retail trade.

I would like to turn briefly to those areas where the FSUC long-range program sees a need for statistical improvements but where the Economic Report and the Budget are silent as to public policy needs.

DEMOGRAPHIC AND MANPOWER STATISTICS

Better current data on population, household, and labor force: For many kinds of business planning, for adequate current information on employment and unemployment, and for many kinds of economic analyses it is important to have both current estimates and projections of the population and the number of households, not only nationally, but with some detail at the State or metropolitan area level. Similarly, more detailed information on the labor force is required to meet the challenges of the sixties. Population growth and movement during this decade are also likely to give rise to many problems of importance to the policymaker which will require more adequate information than is now available in this area.

The FSUC long-range program reflects a widespread user concern over the adequacy of current population, household, and labor-force information. It urges the establishment of a second sample to the current population survey as an important initial step toward improving this information. The current sample is being worked to the limit and it will be necessary to establish a second sample if the household survey technique is to yield much more information than it now does.

FOREIGN TRADE STATISTICS

Greater efforts to improve the usefulness of statistical materials gathered by U.S. representatives abroad: Many users of Federal statistics interested in the development of foreign markets for U.S. exports have felt that more effective use might be made of existing materials received from U.S. representatives abroad. Some work in this direction is underway in the Bureau of Foreign Commerce.

Development of foreign trade statistics in terms of the standard industrial classification: This is a prime necessity if we are to have a proper understanding of the impact of foreign trade, both imports and exports, on the economy of the United States. At the present time the classifications relating to imports and exports and that which describes the industrial composition of domestic production and employment are quite different. Yeoman efforts are required to effect a meaningful translation.

It is our understanding that work in this area is now going forward in the Bureau of the Budget. We are looking forward eagerly to the results of this work.

MANUFACTURING STATISTICS

More timely processing of the "Annual Survey of Manufacturers": In the preparation of FSUC's long-range program, our consultation with members indicated that users attach a very great importance to the more timely release of the "Annual Survey of Manufacturers." It would seem that the national economic accountants would also have a great interest in improving the timeliness of the annual survey because of its importance in the abbreviated commodity flow procedures used in preparing the annual revisions of the national income and product accounts published each July in the "Survey of Current Business."

There are many complex problems involved in improving the timeliness of the "Annual Survey of Manufactures" and they cannot be solved overnight. We feel, however, that progress toward their solution would be more rapid if the Economic Statistics Subcommittee of this committe were to express its interest in speeding up this important series.

Improve the timeliness of monthly reports of manufacturers' new orders: The report on manufacturers' sales, new orders, and inventories appears 30 days after the close of the period to which it refers. Manufacturers' new orders for durable goods is widely used as one of the leading indicators for short-run forecasting. An advance report giving key figures from the series on manufacturers' sales, new orders, and inventories would make for a distinct increase in the usefulness of this series. Such advance reports have been prepared for other important series, as for example, retail trade. Census issues an advance report 10 days after the close of the reporting period.

Such an advance report is a practical possibility. Such a report is, in fact, prepared. Census officials have so stated publicly and in writing. Yet the report has not been released. It is our understanding that Census indeed prepared draft releases of this report but has so far been unable to get them approved for publication.

The publication of this advance report would be a major step forward. We hope that the Economic Statistics Subcommittee of this committee will interest itself in this matter. [NOTE.—In the time intervening between Mr. Stein's appearance before the Joint Economic Committee and publication of these hearings this report has been released to the public.]

TRANSPORTATION STATISTICS

Census of transportation: One of the major developments in user interest in statistical information in the last few years has been in the area of transportation. More and more, users from all sectors of the economy are showing an increasing concern about matters relating to transportation and are showing great interest in statistics relating to transportation as an economic activity. Although FSUC's members did not agree as to the need, usefulness, or desirability of a census of transportation in 1958, there is now a strong feeling that a census of transportation is needed in 1963 and that such a census should be regarded as the base for reexamining the whole area of transportation statistics to determine to what extent they meet modern needs.

The 1962 budget seems to favor a census of transportation in 1963. At least, the proposed appropriation language refers to the "1963 Census of Business, Transportation, Manufactures, and Mineral Industries." An examination of the supporting detail on page 435 of the budget document reveals, however, that no funds for planning this portion of the Census are included in the budget estimate. We hope that the overall budget planning for the 1963 economic censuses includes adequate financing for a 1963 census of transportation.

NATIONAL INCOME AND BUSINESS FINANCIAL ACCOUNTS

Better business profits information: The need for improved data relating to business profits has long been recognized by users of the national income and product accounts. A number of budget requests for programs designed to close existing gaps have been proposed but none has received congressional approval.

Users are also concerned about the lack of timeliness in the corporate profits category of the national income accounts. The conference believes that a serious reexamination of the procedures used to develop these data should be undertaken to see whether a global estimate of quarterly profits information relating to manufacturing corporations might not be obtained from SEC–FTC. If such an estimate could be obtained, a substantial improvement in the timeliness of the quarterly corporate profits category in the national income accounts should be possible. Revisions could be made as more complete industry data became available later. We understand that some efforts in this direction have been undertaken. We believe that these efforts might be intensified if this committee were to express an interest in the matter.

Recently the Internal Revenue Service has begun to issue U.S. Business Tax Returns in its "Statistics of Income" series. This publication appears to provide a considerable amount of information useful to the national economic accountants. The conference believes that any plans for new surveys to collect financial information from unincorporated businesses should be laid aside until the value of the data available in the new Internal Revenue Service series can be tested by use.

More frequent reporting of State and local government expenditures: Proposals for quarterly surveys of State and local government finances have been made twice in recent budgets. Twice they have failed to receive congressional approval. State and local government expenditures are too important a factor in the economy to continue to rely on extrapolation of annual data to provide quarterly information for the national economic accounts. Such a quarterly survey, properly organized, could be used to improve the quality of part of the construction put in place series as well. This would help to head off proposals for a special survey of State and local government expenditures for construction.

Anticipatory data on government expenditures—Federal, State, and local: Federal statistical programs now obtain information on the spending intentions of consumers and businessmen. Last year's budget included a proposal to get spending intentions information from State and local governments. Efforts to secure approval of this program should be continued.

The Federal Government, too, should provide information on its spending intentions for periods of 3, 6, 9, and 12 months in advance. Federal expenditures play an important role in the economy that cannot be ignored by any short-range forecaster—whether he is providing estimates for public or private decisionmaking. Present information is entirely inadequate for short-term forecasting purposes. Moreover, the Federal Government can hardly justify its failure to provide information on its spending plans while asking consumers and businessmen to indicate their anticipated spendings in the near-term future.

Geographic detail: The conference welcomes the recognition which the President's Economic Report accords to the need for adequate "regional and area information to facilitate the planning and administration of private and public activities." This is a need which is also widely recognized by users.

In this connection, I would like to draw the committee's attention to the joint Census-Social Security Administration publication County Business Patterns. Page 432 of the budget document describes this as "a report showing for each county in the United States the number and kind of business establishments and their employment and payrolls * * *" and states that it is published biennially.

County Business Patterns receives appropriations on the premise that it is published biennially. It is, in fact, prepared every 3 years, and it appears 2 years or more after the period to which it refers. The timeliness of this publication could be considerably improved. The original program for the 1959 County Business Patterns called for its release and publication in July 1960. This would have been a timeliness gain of at least a year over the schedule for the 1956 edition. This prospective gain did not materialize, and 1959 County Business Patterns has not yet appeared.

The problem involved in this case is basically one of improving the cooperation between Census and the Social Security Administration. We would like to see the Economic Statistics Subcommittee interest itself in this publication. If the release of County Business Patterns could be speeded up by a year or more, its potential value to users would be enormously increased.

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.

LONG-RANGE PROGRAM FOR STATISTICAL IMPROVEMENTS

President's Economic Report and 1962 budget	*Federal Statistics Users' Conference long-range program*
DEMOGRAPHIC AND SOCIAL STATISTICS	
	Better current data on population and household changes (pp. 7–8).
Improvements in health statistics including special studies of medical care of the aged, and inauguration of health records survey.	
Reduction of backlog in educational statistics processing and expansion of professional statistical staff of Office of Education.	
LABOR STATISTICS	
Studies of the characteristics of the unemployed; analyses of significant provisions of collective bargaining agreements; effects of foreign trade on employment.	Adequate data on manpower, wages, productivity and labor uses to meet the needs of the sixties (pp. 8–9).

President's Economic Report and 1962 budget—Continued	*Federal Statistics Users' Conference long-range program*—Continued
FOREIGN TRADE STATISTICS	
	Greater efforts to improve the usefulness of statistical materials gathered by U.S. representatives abroad (p. 9).
	Development of foreign trade statistics in terms of the standard industrial classification used for statistics relating to the domestic economy (pp. 9–10).
Inauguration of a series relating to international air cargo shipments.	
Study of the feasibility of developing a series on manufacturers' orders for export.	
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CONSTRUCTION STATISTICS	
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	More timely processing and release of Annual Survey of Manufactures (p. 13).
Expansion of sample to provide more industry detail on manufacturers' sales, new orders, and inventories.	
Study of feasibility of weekly series on manufacturers' sales, new orders, and inventories.	
	Improve the timeliness of manufacturers' new orders, especially new orders of durable goods by use of an Advance Report (p. 5).
New commodity surveys to provide data on production of electronics and electrical equipment, rubber products, drugs and medicines, and selected kinds of machinery.	To the extent that Census has an opportunity to add new commodity surveys to its Current Industrial Reports, it would seem desirable to give priority to products which are of growing importance (p. 13).

President's Economic Report and 1962 budget—Continued	*Federal Statistics Users' Conference long-range program*—Continued
BUSINESS	
Improvements in retail trade statistics to provide weekly total retail sales series and sales of household goods and apparel stores; a monthly regional series for total sales and sales of household goods and apparel stores, and a monthly series on sales of household goods and apparel stores for each of the 20 largest metropolitan areas.	Inclusion of merchandise line statistics in the next Census of Business and continued efforts to improve current retail and wholesale trade data (pp. 13–14).
Monthly survey of service trade receipts.	
Quarterly survey of consumer buying intentions.	Quarterly survey of consumer buying intentions supported (pp. 13–14).
AGRICULTURE	
Expansion of enumerative surveys and objective yield techniques for making crop and livestock estimates to certain Corn Belt and winter wheat States.	Modernization of agricultural data both as regards statistical techniques employed and as regards the kinds of data produced (pp. 3–5).
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TRANSPORTATION	
1962 budget includes an appropriation request of "1963 Censuses of Business, Transportation, Manufactures and Mineral Industries" which includes no funds for planning for a Census of Transportation.	Census of Transportation needed (pp. 14–15).
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President's Economic Report and 1962 budget—Continued	*Federal Statistics Users' Conference long-range program*—Continued
Weekly Indicators	
Increase the number of weekly series so important to the appraisal of economic conditions and outlook at critical points in the business cycle.	The conference would assign a relatively low priority to the development of additional weekly indicators in the absence of a strong demonstrated public need for such data (p. 15).
Geographic Detail	
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	Numerous references to the need to improve timeliness (pp. 4–5).

A Long-Range Program for the Improvement of Federal Statistics

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A Long-Range Program for the Improvement of Federal Statistics

BACKGROUND TO THE REPORT

During the 4 years of its existence, the Federal Statistics Users' Conference has contributed significantly to improving Federal statistics. It has encouraged and supported numerous proposals for statistical improvements which have been consistent with the conference's objective of developing a Federal statistical program of optimum usefulness at minimum cost.

NEED FOR CRITERIA TO EVALUATE STATISTICS PROGRAMS

In working for better statistics, the conference has been guided by views expressed by members in responses to questionnaires; by the round-table discussions at the annual meetings; and by the detailed work of its committees. There has been, however, a noticeable lack of a general framework for evaluating the many proposals for statistical improvements which are made.

As an initial criterion for evaluating proposed programs of statistical improvement, the conference accepted the concept of an "integrated Federal statistics program" which was the basis for the President's budget in 1958. This concept focuses attention on the national economic accounts and on those statistical programs which contribute basic data to them. The concept has many useful applications and has been successfully used to bring about several needed improvements.

It is, nevertheless, a limited criterion, and additional criteria are needed to judge the relative worth of many important statistical programs which are at best only indirectly related to the national economic accounts.

CONFERENCE COMMITTEE ON LONG-RANGE IMPROVEMENTS

In November 1959 the board of trustees established a committee on long-range improvements in Federal statistics to develop a general framework for evaluating the present effectiveness of Federal statistics programs and the relative importance of specific proposals to improve them. This report is the result of the committee's activity since that time. It was discussed in draft and amended at the conference's annual meeting. As amended it was submitted to the entire conference membership for further amendment. In its present form it was approved by the board of trustees of the Federal Statistics Users' Conference on November 30, 1960.

SEARCH FOR A FRAMEWORK

There is no single framework—no single overall set of criteria against which all existing and proposed statistical programs can be evaluated.

The variety and complexity of American society gives rise to a multitude of needs for information. An adequate set of criteria for evaluating Federal statistics programs must arise out of the uses to which these data are put and must recognize that the same body of data are used for many different purposes.

An adequate set of criteria must recognize that the relative importance of different kinds of statistical information change as conditions change.

An adequate set of criteria must be flexible. It must allow for the development of new ways of looking at important problems. It must recognize that technical developments associated with data collection and processing open many new possibilities not now conceivable, or, if conceivable, not practical. It must not be bound to any particular way of presenting statistical information, no matter how hallowed by habit or tradition.

This report is based on a survey of the uses of Federal statistics by members of the Federal Statistics Users' Conference. Members also indicated their views on specific needs for improvement in each of the six major areas of Federal statistics: demographic statistics, labor statistics, price statistics, production and distribution statistics, construction and housing statistics, foreign trade statistics, and national income and business financial accounts.

The conference also sought the views of statistics-producing agencies on the long-term need for improvements in their programs. Finally, it consulted with a number of individuals who have used Federal statistics in developing studies or policy recommendations on public issues of vital importance.

Out of the detailed examination of more than 250 suggested needs for improvement, certain general criteria have emerged which are useful in the evaluation of those proposals and in the continuing examination of existing programs: These are—

1. Statistical programs which serve multiple and widely felt needs should have priority over those which serve limited purposes. For example, a second sample to the current population survey could be used to produce information essential to a better understanding of problems related to employment and unemployment; it would yield information to keep population statistics up to date between decennial censuses, it would provide needed support for a quarterly survey of consumer spending intentions; and it would be a flexible tool for providing prompt information for a variety of other purposes.
2. As a corollary to this criterion, every statistical program, existing or proposed, should be considered in terms of possible uses to which the information can be put and should be designed to provide optimum usefulness for these different purposes. Participants in the roundtable discussion on interindustry studies at the conference's 1959 annual meeting felt that the interindustry purchases and sales study now under way in the Office of Business Economics does not give sufficient emphasis to the possible uses of the study for purposes other than general economic and business analysis.

3. New programs, or existing programs, which have been substantially expanded should not be further expanded until the information made available from the previously expanded program has met the test of usefulness. For example, there appears to be a very considerable interest in many of the kinds of information on wages, productivity, fringe benefits, etc., which will flow from recently expanded programs in the Bureau of Labor Statistics. Since this information is only now beginning to become available, it is not clear whether the new programs will or will not meet user needs. It would seem desirable to reserve judgment on further additions to these programs until users have had an opportunity to test forthcoming information against their needs.

4. Competing demands for limited resources require both users and producers of statistical data to make a continuing evaluation of the relative usefulness of existing and proposed programs. New programs should not be initiated at the expense of essential existing programs. At the same time alleged needs of existing programs should not be used as a means of discouraging the development of new and promising ideas.

5. Existing data sources should be used as fully as possible as an alternative to starting a new statistical program. For example, there has been a long-felt need for better information on the profits of unincorporated businesses. Several proposals to meet this need have been made. None has received congressional approval. Just recently, Internal Revenue Service, as part of its statistics of income series, has begun to issue an annual publication called U.S. Business Tax Returns. This may meet many of the needs for better information on this sector of the economy. Further proposals to develop profits information from a survey for the specific purpose should be laid aside unless it can be shown that the IRS data are inadequate.

These criteria are incomplete. They do not deal with a number of problems of major importance to users of Federal statistics. The conference would like to draw attention to three of these areas.

The emphasis which users give to the need for timeliness, to the need for geographic detail, and to the need for better product information in Federal statistics, attests to the importance which these data have for a wide variety of nongovernmental purposes.

The emphasis on the need for timeliness reflects concern for keeping close watch over the current performance of the economy, and the great need for improving information for short-term forecasting.

The growing demand for information at less than national levels and for improvements in product detail comes only in part from those users who are concerned with the problems of a particular area or a particular industry. Users who are concerned with the economy as a whole have become increasingly aware of the need for breakdowns of highly aggregated national totals as they find that effective use of national aggregates requires a more detailed understanding of the "building blocks" which make up the aggregates.

1. Timeliness

The most widespread single complaint about Federal statistics in general is that much of their usefulness is lost because of lack of timeliness. As the conference's timeliness committee discovered, there is no common cause for the lack of timeliness of various series. Without a common cause for the complaint, no common remedy can be prescribed for it.

Since there is no common prescription for meeting timeliness problems each one must be dealt with separately with means appropriate to the particular case. The conference suggests the following general propositions for use in dealing with timeliness problems:

(*a*) Concentrate initial efforts on improving the timeliness of basic indicators or benchmarks.

(*b*) In cases where several indicators are used together, the basic objective should be to improve the timeliness of the slowest series to the point that it has the same timeliness as the average for all basic indicators in this group. (For example, of the "leading indicators" of the National Bureau of Economic Research, the series on new orders of durable goods is the most tardy. In this case efforts should be concentrated on improving the timeliness of this series).

(*c*) If the basic objective cannot be achieved by present procedures, preliminary data from a sample of replies might be used to indicate trends. (This is not a novel procedure. Internal Revenue Service does this to get out a "flash report" of immediately useful items from individual income tax returns and the Bureau of the Census uses this to develop its "Advance Retail Trade Report," to name but two examples).

2. Geographic detail

More and more, users of Federal statistics are concerned about the lack of less than national data in many Federal statistical series. There is an ever-growing recognition that many problems of national significance require information at less than national levels if they are to be dealt with effectively.

The geographic detail found in current Federal statistics (as opposed to such periodic programs as the major censuses) appears to have resulted more from happenstance rather than from logical planning. Some series have detail by metropolitan areas, some by States, some by census regions or divisions.

In some cases the geographic detail seems to be an illusion because it does not add significantly to already existing knowledge. For example, current retail trade statistics by four census regions would seem to provide but little additional information or value to most users of these data. Its main justification would appear to be that it is easy to ge under existing procedures.

There are no objective standards for determining what degree of geographic detail should be supplied by Federal statistics programs. FSUC's Construction Statistics Committee considered this problem briefly and suggested that "significant geographic detail" should be that objective. As used by the committee, "significant geographic detail" meant that the detail provided should be significant in relation to the economic phenomenon being reported.

A related problem concerns the composition of the geographic units for which Federal statistics are reported. Census regions and divisions in their present form were established in 1910. Many users of Federal statistics find these grouping to be unsuited to the needs of the 1960's. Similarly, the continuing dramatic urbanization and suburbanization of the United States with the prospect of "megalopolis" looming ahead, suggests that the standard metropolitan statistical area as it is known today may have a more limited usefulness in the future. The conference believes that there is a need for an early review of the geographic units for which data are published together with an examination of alternative proposals which have been advanced to determine whether some new arrangement might better meet present-day needs.

Cost is often urged as a barrier to improving geographic data in Federal statistics. The cost of providing additional detail, like the cost of providing any other kind of statistical information or of introducing other kinds of important improvements into existing statistical programs, is an important factor which will always ration the amount of detail provided. The conference believes that the question of cost in relation to benefits should always have the highest priority in evaluating how best to use the limited resources available for Federal statistics programs. There can be no indiscriminate expansion of geographic detail in Federal statistics, but the question of cost should be examined carefully in connection with each specific proposal, not used as a shibboleth to foreclose serious consideration in advance.

3. Product detail

Many users have expressed a need for more product detail in Federal statistics. In this instance there are existing objective criteria for including a product in statistical reports. In the census of manufactures the general rule is that a new product must have annual sales of $15 million in order to be included in the census. A product already included in the census is a candidate for deletion if its sales fall below $5 million per year. To be included in the annual survey of manufacturers a product must have anual sales of at least $50 million. In addition, data processing procedures impose a limit of nine products for a single industry.

The rules for including a product in a commodity survey in the current industrial reports series are less well defined. In general, a product must have annual sales of at least $5 million to be included in such a survey. In some cases, additional product detail is available when paid for by the industry concerned.

The conference has found no general support for altering the present criteria for determining product detail in statistics programs.

APPLICATIONS OF CRITERIA TO MAJOR STATISTICAL PROGRAMS

A. Demographic statistics

The conference's survey of uses of Federal demographic statistics by members reveals a widely felt need for improved information on population and household changes in intercensal years. Needs most widely felt by members include qualitative improvements in current population estimates and improved projections of population for the Nation as a whole, for States, and for metropolitan areas. There was special recognition of a need for research into the elements affecting interregional migration in order that projections might be more than the mechanical extrapolation of recent trends.

The principal tool used in the development of current demographic statistics is the current population survey of the Bureau of the Census. Its effectiveness and versatility have been well recognized and extensively used. The current sample is being worked to capacity. If the current population survey is to be utilized to meet the many needs for more adequate intercensal information on the population, it will be necessary to establish a second sample for the survey.

Additional resources devoted to current population statistics programs and particularly to the creation of a second sample for the current population survey, would provide flexible tools for obtaining better intercensal demographic data. In addition, a second sample for the CPS could be used to develop needed information relating to employment and unemployment, and would enable the Census Bureau to conduct such other programs as the quarterly survey of consumer intentions without sacrificing other essential information.

There is also a considerable interest in a proposed middecade census. This program would provide a wealth of local detail far beyond that which could be provided by a reasonable expansion of the current statistics program. It would supply more exact demographic data for States and smaller political subdivisions which could not be obtained from sample surveys.

Such a middecade census, while attractive, would also be expensive. Its total cost would probably be around $50 million, a sum greater than the annual cost of all current Federal statistics programs put together.

The conference believes that the improvement of the current population statistics program, including the creation of a second sample for the current population survey is the first priority need for improvement in demographic statistics. A middecade census would provide much useful information, but consideration of its cost relative to its value cause the conference to hesitate to recommend it in the absence of compelling evidence of the need for such a census for public policy decisions. An expanded sample of the current population survey at middecade to provide additional detail would be worth considering as an alternative to a middecade census.

B. Labor statistics

There is a broad user recognition that available data relating to manpower, wages, productivity, and labor uses are inadequate to meet the need of the decade on which we are newly entered.

In the section of this report dealing with demographic statistics, it was suggested that the development of a second sample for the current population survey would provide a flexible tool for developing a number of different kinds of information. Among other things, it could be used to expand the sample of the monthly report on the labor force to provide more detailed information on the unemployed, young workers, older workers, and occupational mobility. It might also be a vehicle useful for developing current estimates and projections of the labor force by States and for metropolitan areas.

Current labor force and earnings statistics by occupation are considered to be important by many users. The conference favors the continuation of efforts designed to overcome the problems involved in developing additional data of this nature. Such data, if they can be obtained at reasonable cost and without imposing an excessive reporting burden on respondents, would be a notable addition to existing information. While conceptual and data collection problems may preclude the early expansion of current labor force and earnings information by occupation, a survey which would follow a sample of workers through the business cycle, showing what kinds of jobs they have, what kinds they leave, and what kinds they get again might meet some of the informational needs in this area. Such a survey could also be used to meet some of the needs for information on young workers, older workers, and occupational mobility mentioned in the previous paragraph.

There is a great user interest in improving employment and earnings data for small areas. Existing employment data relating to metropolitan areas varies widely in available detail as between areas. The conference urges that priority be given to improving detail in those areas where it is now deficient before adding additional areas for which data are published.

Improved information on nonmanufacturing employment is vitally needed, particularly in areas relating to trade, services, and State and local government.

The conference recognizes the importance of obtaining better information on such important matters as wages, productivity, and fringe benefits.

These programs have only recently been expanded, and users have not yet had an opportunity to become familiar with the information now being developed. The conference feels that further expansion in these areas should await an evaluation of the adequacy of new data in terms of user needs.

Problems relating to the impact of automation have already attracted considerable public attention and will continue to grow in importance. Statistical information on the subject is lacking. Questions of public policy call for the development of data in this area at an early date.

The conference believes that it would be worth while for the Bureau of Labor Statistics to develop and public on a systematic basis an analysis of the type and prevalence of provisions of collective bargaining agreements. Such an analysis would be useful to both sides in management-labor negotiations.

C. Foreign trade statistics

Members of the conference have not shown as great an interest in these data as in statistics relating to other major areas of the Federal statistics program. Many users appear to have a greater interest in the information on foreign markets obtained from U.S. representatives abroad than they do in statistical information on U.S. exports and imports.

Users of statistical data gathered by U.S. representatives abroad strongly feel that there are great opportunities for improving the usefulness of these materials. The lack of an adequate indexing of materials and delays in the release of materials used for articles in Foreign Commerce Weekly are two of the more important criticisms which have been heard.

The lack of timeliness of current foreign trade statistics appears to be a common complaint. The Census Bureau has pointed out that any substantial improvement in timeliness would require the establishment of a cutoff date about 10 days before the close of the month reported on. All trade after that date would be included in the report for the next succeeding month. The Bureau of the Census should make a concerted effort to get user reaction to this proposal.

There is evidence of considerable user interest in information which would increase understanding of the impact of foreign trade on the economy, including the effects of exports and imports on employment.

One proposal for providing information on this important matter stresses the value of recasting import and export statistics into the Standard Industrial Classification categories used for statistics relating to the domestic economy. This suggestion has been a hardy perennial for many years, but has never gone beyond the discussion stage. It now appears that it would be possible to develop such a program for export statistics without undue difficulty. The conference feels that this would be a worthwhile addition to the foreign trade statistics program because it would make the data more usable for many purposes and for many users.

The extension of such a program to import statistics at the earliest practicable moment would also be desirable.

D. Price statistics

The conference will make a comprehensive review of this important area of Federal statistics after the report of the price statistics review committee becomes available for users to examine and study.

E. Construction and housing statistics

The conference's committee on Federal construction statistics in 1959 prepared a report on long-range improvements in Federal construction statistics. That report took several months to prepare and was reviewed in draft by some

200 users of Federal construction statistics. It identified 10 specific priority needs for improvement as follows:

First priority:

(*a*) Regular survey of the characteristics of new housing.

(*b*) Series on expenditures for maintenance and repairs, additions, and alterations until adequate data are developed for all major categories of construction.

(*c*) The elimination, insofar as possible, of inconsistencies between current housing starts data and benchmark data of the Census of Housing and National Housing Inventory.

(*d*) Continuation of the National Housing Inventory as a regular feature of the Federal statistics program.

(*e*) Development of an adequate cost of construction index.

Second priority:

(*a*) Additional geographic detail in construction activity data.

(*b*) Development of more adequate measures of employment in construction.

(*c*) Development of anticipatory data relating to planned expenditures for construction.

Third priority:

(*a*) Development of interindustry studies to provide benchmark information on the use of materials in construction.

(*b*) Inauguration of a quarterly survey of State and local government expenditures as a vehicle for improving estimates of State and local government construction.

Since the release of Long Range Improvements in Federal Construction Statistics a year ago, some improvements in construction statistics have been made. Others are in process. Some of these move in the direction of meeting the priority needs identified in the report, but not sufficiently far to call for a restatement of these needs.

Long Range Improvements in Federal Construction Statistics devoted considerable attention to the need for improving statistics relating to the value of nonresidential construction put in place, but did not include any mention of this need in its list of priorities. The report assumed that work in this area was going forward with additional funds which had been provided for the purpose in 1958 and that an explicit statement of the priority need for the improvement of this series was not necessary.

It is clear that the value-put-in-place series is of major importance. It is clear that the nonresidential portion of this series is in particular need of improvement. The proposed census program of progress reporting on private nonresidential construction would constitute a major improvement in this area and would have been included in the first priority except for the fact that some work in this area was already in progress at the time the report was prepared.

As for the other components of the nonresidential portion of the value-put-in-place series, some improvement should be forthcoming from a series on maintenance and repairs, additions, and alterations (a first priority item), some improvement could come from a quarterly series on State and local government expenditures (a third priority item) and some improvement might be obtained in other areas through closer cooperation with trade associations. The conference's committee on Federal construction statistics recognized the need to improve the value-put-in-place series. It recognized also that a progress-reporting type of survey for every segment of the value-put-in-place series would be very expensive. As a consequence, "Long-Range Improvement in Federal Construction Statistics" called for the employment of a variety of means to improve existing data as an alternative to embarking upon an expensive and extensive program of surveys.

The conference continues to believe that the approach outlined in "Long-Range Improvements in Federal Construction Statistics" is sound. While this approach would yield information of a lower quality than that which would be obtained by a thoroughgoing program of surveys, it would provide data of a considerably higher quality than that now available at a cost considerably below that of a progress-reporting survey covering every segment of the value-put-in-place series.

F. Production and distribution statistics

Statistics relating to the production and distribution of goods and services make up a large part of all current Federal statistical information. About one-third of all expenditures for current statistical programs go to providing data in this broad area which includes agriculture, manufacturing, wholesale and retail trade, and the service industries. Such data on transportation as are available have been gathered as an adjunct to Federal regulatory or public works programs, and are designed primarily to meet those needs rather than the broader informational purposes served by statistics relating to agriculture, manufacturing, and trade.

Agricultural statistics.—Despite the variety and amount of statistical information relating to American agriculture there is a growing concern about its adequacy for the need of present-day public and private policy decisions.

Agriculture as an industry has changed radically in the past 25 years. Rural society is changing, too. Yet, for the most part, available information continues to portray American agriculture in terms which were more applicable a generation or more ago than they are today.

The use of direct measurements and sample surveys in making crop and livestock estimates, a development which is only now getting underway, is an encouraging step forward. It is to be hoped that this improvement program will be expanded systematically and that its objectives will include the development of estimates an intervals consistent with present-day production practices. As the use of these techniques is expanded geographically to include the whole country, it should become possible to employ them as a valuable and flexible tool for obtaining a variety of kinds of needed information not now available.

But the use of modern techniques is not enough. There is also a need to change the way of looking at American agriculture. Less attention should be given to averages. More attention should be given to developing current information by economic class of farm and by kinds of commercial farms. Such a framework would provide more meaningful information than does the present system which produces primarily per farm or per capita data.

Manufacturing statistics.—The conference has been concerned about the lack of timeliness of the Annual Survey of Manufacturers. The situation regarding this report is becoming intolerable. Even granting the special circumstances prevailing in the year following the Census of Manufacturers there can be no excuse for sending questionnaires to respondents 6 months or more after the close of the year to be reported on, as was the case this year. This kind of delay guarantees that the Annual Survey will have only historical value. The Census Bureau needs to reexamine the procedures it uses in collecting and processing the Annual Survey and a high priority should be given to improving its timeliness.

Users have expressed a great interest in improving geographic detail of intercensal manufacturing statistics in order to better understand developments taking place in the little economies in the years between successive censuses. Likewise, users have expressed a need for more product detail in current manufacturing statistics.

The conference believes that improvements of this nature are important, but that they take second priority to the need of improving the timeliness of the Annual Survey of Manufacturers.

To the extent that Census does have an opportunity to add new commodity surveys to its Current Industrial Reports series, it would seem desirable to give priority to products which are of growing importance. Efforts should be made to develop growth criteria to be used along with value criteria in determining what products should be in new commodity surveys in the Current Industrial Reports series.

Retail and wholesale trade.—Users of trade statistics are interested mainly in these things: The total amount of trade being carried on; commodity or similar detail describing the kind of trade being carried on; useful geographic detail which describes where trade is being carried; and useful inventory information which relates the level of stocks of goods in the distribution pipeline to those being produced and those disappearing in consumption.

The Conference on Federal Distribution Statistics held on September 28, 1960, produced a number of specific recommendations for statistical improvements which will be the subject of a special report. The exact form in which these recommendations will be stated is not now available, but their general import is clear.

1. Federal Reserve weekly department store sales data have been widely used as a current indicator of consumer spending. The discontinuance of this series without first providing something in its place would be a major loss of information. The proposed expansion of the current census retail trade program to include a weekly indicator which would provide data for department stores

and also for a broader category of retail trade would be a welcome improvement in current retail trade statistics.

2. The need for merchandise line statistics in the census of business is becoming increasingly important as changes in distribution practices make kind of business categories less useful as indicators of the kind of trade being carried on. This is more important in statistics relating to retail trade than in those relating to wholesale trade. In statistics relating to wholesale trade, a finer kind of business breakdown and a general reexamination of the kind of business categories in terms of modern business practices would meet major user needs.

3. Some kind of current statistical information on sales and inventories of important commodities is needed if trade changes are to be properly understood. Whether this can best be done in terms of departmental sales and inventories or merchandise line sales and inventories or whether efforts should be concentrated on "big ticket" consumer items is a matter which such practical considerations as ease of collecting information, existing accounting practices, and relative cost of developing information will determine. The development of adequate information of this character will probably take several years. Initial programs will probably be disappointing in terms of user needs, and continuing efforts will be required to get the kind of information most useful for both public and private policy decisions.

4. Geographic detail in current trade statistics is extremely important. For most users and would-be users of Federal statistics on wholesale and retail trade, national totals are woefully inadequate. For many, national totals are simply unusable. Trade data needs a finer kind of breakdown than that provided by census regions or divisions. Of all existing statistical geographic units, the standard metropolitan statistical area is perhaps the one best suited for developing adequate current trade information. The need for a comprehensive review of the geographic units for which data are developed and published has been noted earlier in this report.

Transportation statistics.—Congress has authorized but has never provided funds for a census of transportation to be taken every 5 years. The question of whether to conduct such a census may arise again as plans for the 1963 economic censuses are developed.

Information on transportation now provided by Federal statistics has been shaped primarily by the administrative needs of regulatory agencies. Almost no attention has been given to the importance of statistics about transportation as an important economic activity.

The conference believes that the time has come to make a fundamental reexamination of the needs for statistics relating to transportation. A census of transportation would be a useful device for providing essential economic information about this important area. With these data in hand it would be possible to conduct a meaningful review of the present statistical programs of regulatory agencies.

Weekly indicators.—Recently there has been evidence of a growing interest in developing additional series of weekly indicators of general economic importance. The conference has considered this idea in principle. It has concluded that the interest in weekly indicators probably arises out of the economic uncertainty of the times. It questions whether the economy itself or the processes of decisionmaking are of such volatility as to justify any considerable expansion in the number of weekly indicators. The conference would assign a relatively low priority to the development of additional weekly indicators in the absence of a strong demonstrated public need for such data. To meet the need for prompt information on important economic developments, the conference believes that serious efforts might be devoted to improving the timeliness of existing monthly indicators, even to the point of using new methods for getting "flash" indicators as outlined earlier in this report.

G. National income and business financial accounts

Users of these data have stressed the need for (1) better business profits information, (2) more frequent surveys of State and local government expenditures, and (3) anticipatory data on Federal, State, and local government expenditures. Users also indicate a strong interest in the development of sufficient detail to permit area analysis.

The need for better information on the profits of unincorporated business has long been cited by the Office of Business Economics as one of the most important gaps in statistical information used in the national economic accounts. A number of programs have been proposed to fill this gap. None has been approved. The Internal Revenue Service has recently issued a new publication, U.S. Business Tax Returns, which appears to provide a considerable amount of information useful to national economic accountants. The conference believes that any plans for special surveys to collect financial information on unincorporated businesses should be shelved until users have had an opportunity to evaluate the new series being published by Internal Revenue Service.

Users are also concerned by the lack of timeliness of quarterly data on business profits. The procedures for developing quarterly estimates should be reexamined, and serious consideration should be given to developing a preliminary figure for corporate profits even though industry detail may not be available. A global figure 30–45 days after the close of the quarter reported on would contribute significantly to improving the timeliness and usefulness of quarterly national income data. Such a figure would be subject to revision when more detailed information became available. It is believed that such revisions would not be of significant proportions.

Proposals to develop quarterly information on State and local government expenditures have twice been sent to Congress. Twice Congress has rejected them. The conference feels that quarterly data on State and local government expenditures are important because they will give a more current picture of developments in a sector of the economy which is of growing importance, because they can contribute to improving the value put in place series in construction statistics, and because they would contribute to improving the national economic accounts. Efforts to get approval of this important program should be continued.

The conference believes that the development of anticipatory data on State and local government expenditures is also important and that efforts to secure this kind of information should be continued. The work of the conference's Federal Government procurement statistics committee indicates that much of the raw material for an anticipatory series on Federal Government expenditures is already available and needs only rearrangement to be presented as meaningful economic statistics.

Member responses to the conference's inquiry on needs for improvement included many references to the need for data at less than national levels. Users spoke of the need for regional economic accounts, for information on consumer credit by regions, for information on personal income distribution by metropolitan areas, and the like.

Taken together, these responses are another indication of the lively interest which users have in geographic detail in Federal statistics.

Regional economic accounts would require a considerable amount of prior research by the Office of Business Economics. Many problems of an entirely new character would arise. These problems are sufficiently numerous and difficult to suggest that the preparation of full sets of regional accounts should be left to local groups which are particularly interested in regional or area analysis. However, Federal statistics programs which provide benchmark data for this type of analysis should take account of the growing interest being shown in regional economic accounting. In this connection it would be useful for OBE to review its experience in preparing special studies of the Delaware and Potomac River Valleys in order to describe more fully the problems to be overcome in any program seeking to develop area data on a broader scale.

Information on personal income with breakdowns by size classes and type of income, is being developed by the Internal Revenue Service for the 50 largest standard metropolitan statistical areas and less detailed data will be available for the 100 largest metropolitan areas. The conference is encouraged by this development which will mark a major improvement in the information available on personal income at less than State levels in the intercensal years. The value of this information could be greatly increased if OBE has sufficient funds to utilize these data in preparing more comprehensive annual estimates of personal income by metropolitan areas.

Interindustry purchases and sales studies.—The 1958 interindustry study of the Office of Business Economics has had a disappointing financial history. It was started too late, with too little, and will suffer from an appalling lack of timeliness. Nevertheless, important progress has been made—progress which will be seriously slowed down because of the lack of sufficient funds to carry it on at an optimum level. The conference feels that it is important to give this program proper financial support and that it would be a mistake to start any other new work in the Office of Business Economics until this project is properly provided for.

Interindustry purchases and sales studies provide an informational framework valuable in helping to meet many needs for data mentioned in this report. A properly developed program offers opportunities for providing kinds of information not otherwise available.

LOOKING AHEAD

In this report the conference has discussed a long-range program for the improvement of Federal statistics in terms of today's expressed needs. Suggested improvements considered in this context, tend to be shaped by the framework of existing Federal statistics programs. This is a practical way of looking at statistical improvements. The developments over the next several years which will make statistical information more useful will come about primarily through the modification of existing programs.

While the conference has thus limited the scope of this report, some consideration should be given to other possible developments lying further in the future. For example, the growth of new techniques of data processing suggest that it may be possible to develop new kinds of cross classifications of information at low levels of disaggregation—a possibility heretofore neglected because of the limitations of equipment, techniques, and resources. Such a development would vastly increase the usefulness of Federal statistics to those who use these data in their own operations. This is not an idle dream. The value of the 1960 Censuses of Population and Housing will be considerably increased for many users because the data processing techniques employed have opened new possibilities for users to obtain timely and detailed cross-tabulations at moderate cost. Both statistics-producing agencies and users should be alert to possibilities of further developments along this line. Fruitful cooperation between the two should be encouraged to the extent that it is in the public interest.

The rapid development of new techniques in data processing will raise a host of problems affecting Federal statistics and their use over the next decade. Some of these problems can already be seen—the problems of translation of tape processed on one type of equipment to tape usable on another type of equipment, for example. Other problems involving accounting and statistical concepts and practices will surely arise. The conference will establish a special committee to work with other interested groups in exploring ways of utilizing new developments in technology and in accounting and statistical concepts to provide improved information from Federal statistics programs.

OFFICERS

Chairman: Robert J. Eggert, marketing research manager, Ford Motor Co.

Vice chairmen: Peter Henle, assistant director of research AFL–CIO. Angus McDonald, coordinator, legislative services, National Farmers Union. Howard L. Stier, chairman, Census Advisory Committee, American Marketing Association.

Secretary-treasurer: Ralph L. Gillen, associate, McKinsey & Co., Inc.

Executive secretary: Roye L. Lowry.

BOARD OF TRUSTEES

Robert E. Sanders, research director, North Dakota Farmers Union.
Frederick N. Sass, manager, economic analysis, the Pennsylvania Railroad Co.
Ben B. Seligman, research director, Retail Clerks International Association.
Herbert Stein, director of research, Committee for Economic Development.
Howard L. Stier, chairman, Census Advisory Committee, American Marketing Association.
Lazare Teper, research director, International Ladies' Garment Workers' Union.

COMMITTEE ON LONG-RANGE IMPROVEMENTS IN FEDERAL STATISTICS

Otis Brubaker, research director, United Steelworkers of America.
Gerhard Colm, chairman, chief economist, National Planning Association.
Henry G. Corey, director, Economics Division, Continental Oil Co.
Robert S. Eckley, manager, Business Research Department, Caterpillar Tractor Co.
George B. Hurff, member, Associated University Bureaus of Business & Economic Research.
John G. Kruse, assistant secretary, Minnesota Mining & Manufacturing Co.
K. E. Miller, Bureau of Business and Economic Research, University of Missouri, and consultant, Armour & Co.
Robert E. Sanders, research director, North Dakota Farmers Union.
Frederick N. Sass, manager, economic analysis, the Pennsylvania Railroad Co.
C. W. Stanley, manager, Schedule-Statistical Bureau, Brotherhood of Railroad Trainmen.
Frank C. Strohkarck, manager, Administrative Division, Research Department, the Curtis Publishing Co.
W. H. Wieland, comptroller, California Bank.

Ex-officio Members

A. A. Charous, assistant to the economist, Sears, Roebuck & Co.; chairman, committee on Federal distribution statistics.
Miles L. Colean, consultant, Mortgage Bankers Association of America; chairman, committee on Federal construction statistics.
William B. Dale, program manager, international research, Stanford Research Institute; chairman, National Economic Accounts Committee.
Howard L. Stier, chairman, Census Advisory Committee, American Marketing Association; chairman, Committee on Federal Government Procurement Statistics.

The CHAIRMAN. Would you like to ask any questions, Senator Proxmire?

Senator PROXMIRE. Yes.

I would like to ask this question: This is an excellent organization. I am delighted to see it. It certainly does a great deal of good.

I am concerned, however, about your lineup of trustees. I see you have a business group, a farm group, a labor group, a so-called nonprofit groups. The business group which I would presume would embrace small business includes the National Association of Broadcasters, Sears Roebuck, Ford Motor Co., Scott Papers, and the Pennsylvania Railroad.

The chairman of this committee is the head of the Small Business Committee and Select Committee on Small Business in the House.

Senator Sparkman, who was here earlier, is head of the Small Business Committee in the Senate.

I am chairman of the Subcommittee on Small Business in Banking and Currency. We are all interested in small business. We are aware of the fact that small business often needs and wants statistics.

Now, I am concerned about the fact that this fine organization of yours apparently either does not have a category of small business, or as far as businesses that are concerned the people represented among your trustees at least are uniformly and exclusively big business.

Mr. STIER. That is true. We have, however, in our membership people who are not exclusively interested in large business.

Senator PROXMIRE. Good.

Does your organization give any consideration to giving that small business viewpoint an opportunity to be represented among your trustees?

I do not want to butt into what you people want to do, but I think from a congressional standpoint it would be very useful to us because we think a lot of your organization.

Mr. STIER. Yes, sir. I am sure you will find in many of these recommendations that we make here the interest of our small business representatives are indicated here.

Senator PROXMIRE. Often there is a conflict. For instance, we have just had a big fight in the last year over a bill I introduced. a small business bill, that would provide greater publication of Government contracts to make them available to small business.

This was opposed and successfully opposed. We got it through the Senate unanimously, but it did not quite make it in the House.

This is the kind of conflict which it seems to me might not specifically develop within your organization, but I think if you had spokesmen for small business who self-consciously thought of the small business or small business community in terms of their statistical needs, it could be very helpful to your organization and to us.

Mr. STIER. I agree with you. I think I would be safe in saying that our organization has in this long-range program included a number of things here that are really extremely valuable to small business, as a matter of fact, in many respects even more so than to large business.

Sometimes the most important uses of these data are made by small business concerns. The larger business concerns have much of this.

Senator PROXMIRE. Mr. Chairman, that is all the questions I have.

I would like to conclude by saying I think this is an extremely useful idea. I think this is the kind of thing that certainly Congress can assist very, very greatly in helping the business community.

I do not see how anybody can complain about the Congress concerning ourselves with it.

And your advice to people who use the statistics of Government would be just invaluable to us. I shall study this carefully.

The CHAIRMAN. May I ask a question here.

I notice that you state:

> Greater effort to improve the usefulness of statistical material gathered by the U.S. representatives abroad.

In other words, you are suggesting that better statistics on foreign markets be obtained. Do you not feel that such statistics would be especially helpful to small business in finding export opportunities?

Mr. STIER. Yes, sir; they certainly would.

This is not so much Federal trade data as much as it is economic intelligence about the foreign markets themselves, information about the countries and the people who would be buying in those countries.

The CHAIRMAN. That is right. A day or two ago my attention was directed to opportunities we have on one commodity, chickens, for instance. I am told we can produce chickens here in the United States and deliver them to any country in the world and be competitive in that country and make a profit.

That is the only commodity that I have been told about.

Of course, the reason is that it is a highly efficient industry in the United States.

True, the smaller people seem to be going broke, but the larger ones seem to be making money. I am glad that somebody is making money in it; and I wish the smaller producers could, too.

In chicken production, 2½ pounds of feed produces a pound of protein in chicken. In contrast, it requires 4½ pounds of feed to produce a pound of pork; and 6 to 7 pounds of feed to produce a pound of beef.

We have mass production methods of producing chicken and this is one commodity that can be produced in the United States and sold all over the world.

It would help in our balance-of-payments problem if we could just get the chickens into all the countries of the world. Some places do not want us to export to them, like France. We are taking a lot of automobiles from France, but France doesn't want to take any of our chickens. So I thing we need some better traders somewhere along the line.

Mr. STIER. I think you would find a number of other American industries that can compete successfully in the world markets.

The CHAIRMAN. Can you name some?

Mr. STIER. We were talking about this just the other day. Some of the members of our trustees committee made the point that there were a number of areas where we could do a pretty good job of competing successfully in world markets.

The CHAIRMAN. Are they fabricated products, or animal grown products?

Mr. STIER. Some of these are fabricated products where they have a high degree of automation and the production costs are low.

The CHAIRMAN. That is right.

Mr. STIER. You will notice also here a statement about developing Federal trade statistics in terms of the standard industrial classification. This is something we think is very important.

Federal trade statistics now are in terms of a classification that is not identifiable with our manufacturing statistics.

The CHAIRMAN. I think you have rendered a good service in doing this work. I agree with what Senator Proxmire has said. I hope this subcommittee will be continued this year. I do not know whether Mr. Bolling wants to remain as chairman, or not. I believe he will if we twist his arm, so we will try that if we have to. We here the things we think the committee's action would be a very important.

Mr. STIER. I think this committee right here can be extremely effective in many of these things. We have outlined in our statement here the things we think the committee's action would be a very important place to bring to bear. This is one of them right here.

In the annual survey of manufacturers more is needed there.

The CHAIRMAN. Your statement will be inserted in the record.

It is very kind of you to come here and give us the benefit of your testimony.

Would you like to ask any more questions, Senator Proxmire?

Senator PROXMIRE. I have no more questions.

The CHAIRMAN. I understand that Mr. Lowry joins you and endorses what you have to say?

Mr. LOWRY. Yes.

The CHAIRMAN. Thank you kindly, sir.

Mr. LOWRY. Thank you.

Mr. STIER. You are very welcome, sir. We appreciate the opportunity to appear and to render our statement.

The CHAIRMAN. The rest of the hearings have been announced for February 20, 21, 22. The Government witnesses scheduled for these 3 days will be rescheduled to appear during the week of March 6, in order to allow more time for the preparation of additional material.

The specific days and other details will be announced later. Of course, we are working with the people concerned about this and they are in agreement with us. Again, thank you, sir.

Senator PROXMIRE. May I ask the Chairman, the scheduled hearings for February 20, Monday, will be postponed until March 6; is that correct?

The CHAIRMAN. That is correct.

On February 20 we had Mr. Walter Heller, Professor Heller, who is Chairman of the Council of Economic Advisers.

Also, the same day we had Mr. David E. Bell, Director of the Bureau of the Budget.

Now, the next day, the 21st, we had Mr. C. Douglas Dillon, Secretary of the Treasury. In the afternoon of the 21st we had Mr. William McChesney Martin, Chairman of the Board of Governors, Federal Reserve System.

On the 22d, Wednesday, we had Mr. Charles J. Hitch, Assistant Secretary of Defense, Comptroller, Department of Defense.

But we will postpone all those and reschedule them for the week commencing March 6.

Without objection, the committee will stand in recess subject to call of the Chair.

(Thereupon, at 12:45 p.m., the committee was recessed, to reconvene subject to call of the Chair).

JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

MONDAY, MARCH 6, 1961

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

The committee met at 10 a.m., pursuant to call, in room 318, Senate Office Building, Representative Wright Patman (chairman) presiding.

Present: Representatives Patman, Bolling, Boggs, Reuss, Griffiths, and Curtis; Senators Douglas, Sparkman, Proxmire, Pell, and Bush.

Also present: Wm. Summers Johnson, executive director; and John W. Lehman, deputy director and chief clerk.

Chairman PATMAN. The committee will please come to order.

Today we resume hearings on the 1961 Economic Report of the President, with the first of the administration witnesses. As I stated on the first day of these hearings, the situation this year is unusual in that the President's Economic Report was filed by the outgoing President. The only other time this circumstance has occurred was when President Eisenhower took office in 1953.

At that time, there was a delay in the appointment of the President's Council of Economic Advisers, and no Joint Economic Committee report was filed. This year the Council of Economic Advisers was appointed soon after the President's inauguration, and several economic messages from President Kennedy have already been received by the Congress.

The current hearings, therefore, will cover the report filed by President Eisenhower, and the economic messages and views of the new administration.

Before I call on Dr. Heller and the other members of the Council, there are some changes in the hearing schedule to be announced.

The appearance of Budget Director Bell, scheduled for this afternoon, and Assistant Secretary of Defense Hitch, scheduled for Wednesday morning, have been postponed until later in the month.

Chairman Martin will appear at 2:30 tomorrow afternoon rather than 2 o'clock, as first announced.

Dr. Heller, you have made many appearances before this committee and its subcommittees. We have always found you highly competent in these discussions and your Council has been most helpful. We welcome you and your associates and ask you to proceed in your own way. You can identify yourself and your associates, if you please.

STATEMENT OF WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY KERMIT GORDON AND JAMES TOBIN

Mr. HELLER. Thank you.

I am Walter Heller. On my right is James Tobin, and Kermit Gordon is on my left.

May I say at the outset, Mr. Chairman, to you and to the members of the committee, that I have no intention of reading all of the 56 pages of testimony that you see before you. I thought you might need that reassurance lest there be any misunderstanding on this point.

Chairman PATMAN. There being no objection, Dr. Heller, you may cover the part that you desire and the remainder will be inserted in the record in order, including the charts and tables.

Mr. HELLER. Thank you very much. Then, with your permission, I would like to read selectively the key passages and summarize the material between the verbatim readings.

Mr. Chairman and members of the committee, we have looked forward with genuine pleasure to this first appearance before the Joint Economic Committee. The committee's studies and reports are among the references most frequently used by the Council—and indeed by the economics profession and by business—as a source of economic information, analysis, and wisdom.

We sincerely hope that we can continue to benefit from and perhaps contribute to the high standards of research and investigation to which the committee and its subcommittees have adhered.

The submission of a prepared statement by the Council to the committee is, to the best of our knowledge, without precedent. Indeed, this is the first time since enactment of the Employment Act of 1946 that a council has testified before the joint committee on the occasion of a change of administration.

In all previous years save 1953, when Council operations were temporarily suspended, the Council could, in effect, let the annual Economic Report serve as its statement on economic conditions and policy. We are not in this position.

We do not mean to suggest that our written statement can serve as a fully developed Economic Report; there have been, after all, only 44 working days since January 20, including Saturdays and Sundays.

Nevertheless, a new President has taken office, and an administration has been organized which looks at our economic problems in a new perspective. Accordingly, we have felt under obligation to present to this committee a reasoned and fairly lengthy statement of the Council's views.

In our testimony today, we first examine briefly with you the role of the Council as we conceive of it. Second, we review the serious problems of recession, chronic slack, and inadequate growth rates in the American economy today.

Because of the length of our analysis, as indicated, we will ask that some of this material be handled by reference than by a full reading before the committee.

Third, we examine the broad lines of policy that are appropriate to the current problems of the economy, particularly in terms of the program which the President has announced in his state of the Union message and his message of February 2, "Program To Restore Momentum to the American Economy."

We shall discuss with candor the problems and prospects of the American economy, neither minimizing its difficulties nor underestimating its capacity to overcome them. Workers, consumers, and businessmen would surely not gain confidence in the future of the economy from official reassurances that plainly contradict or ignore their everyday experiences and observations.

Economic confidence will be better sustained by evidence that the Government assesses real problems soberly and attacks them resolutely. The public will in the long run have confidence in the Government only if the Government shows confidence in the public.

THE ROLE OF THE COUNCIL OF ECONOMIC ADVISERS

On the occasion of the first appearance of this Council before the Joint Economic Committee, we wish to express some general principles that we hope will guide our future relationships with the committee. They have no special relevance to the particular subject matter of our first testimony, but are designed to set the stage for what we hope will be a period of mutual understanding and constructive cooperation between the Council and the committee.

1. The Council has a responsibility to explain to the Congress and to the public the general economic strategy of the President's program, especially as it relates to the objectives of the Employment Act. This is the same kind of responsibility that other executive agencies assume in regard to programs in their jurisdictions.

2. It is not appropriate or necessary for the Council to go into the details of legislative proposals or of administrative actions which fall primarily in the domain of operating executive departments or agencies who can and do testify before the appropriate committees. Our concern is with the overall pattern of economic policy.

3. The program of the President is, of course, the outcome of a decision process in which advice, recommendations, and considerations of many kinds, from many sources, inside and outside the Executive, play a part. The professional economic advice of the Council is one element; it is not and should not be the sole consideration in the formulation of Presidential economic policy, or of congressional policy.

4. In congressional testimony and in other public statements, the Council must protect its advisory relationship to the President. We assume that the committee does not expect the Council to indicate in what respects its advice has or has not been taken by the President, nor to what extent particular proposals, or omissions of proposals, reflect the advice of the Council.

The CHAIRMAN. The committee appreciates, of course, that the function of the Council is to give advice to the President. Accordingly, we will try to keep our questions within a scope which does not transgress on privileged matters.

Mr. HELLER. Thank you very much.

5. Subject to the limits mentioned, members of the Council are glad to discuss, to the best of their knowledge and ability as professional economists, the economic situation and problems of the country, and the possible alternative means of achieving the goals of the Employment Act and other commonly held economic objectives.

In this undertaking, the Council wishes to cooperate as fully as possible with the committee and the Congress in achieving a better understanding of our economic problems and approaches to their solutions.

6. The Council is composed of professional economists, but economic policy, as the committee well knows, is not an exact science. Senator Proxmire, as I recall, likens it to economic phrenology. The Council is, and necessarily must be, in harmony with the general aims and direction of the President and his administration. A member of the Council who felt otherwise would resign. This general harmony is, of course, consistent with divergences of views on specific issues.

We should also note in this introduction that the President has expressed his intention to "return to the spirit as well as the letter of the Employment Act of 1946," and to have the economic reports "deal not only with the state of the economy, but with our goals for economic progress." The committee will find this desire reflected in today's testimony and in future Council reports as well.

Further, the President has stated that we should not "treat the economy in narrow terms, but in terms appropriate to the optimum development of the human and natural resources of this country, of our productive capacity, and that of the free world."

To carry out these larger responsibilities, the President asked the Chairman of the Council "to find ways and means of providing us with the best possible staff assistance and advice." We hope that it will be possible to restore the Council staff at least to its size of 8 or 10 years ago so that the Council will be in a position to meet its full responsibilities as envisioned by the President and the Congress.

I would like to deal first in the substantive part of this testimony with the state of the economy as we see it.

In spite of great inherent strength, the American economy today is beset not only with a recession of nearly 10 months' duration, but with persistent slack in production and employment, a slowdown in our rate of growth, and pressure on our international balance of payments.

RECESSION AND CURRENT OUTLOOK

The fourth postwar recession of economic activity in the United States began last spring. May 1960 is generally taken as the peak month, although some cyclical measures began to fall earlier and some later.

As I recall, Mr. Geoffrey Moore, of the National Bureau of Economic Research, in discussing the key turning point, agrees with this identification of May 1960 as the point which marks the inception of the 1960–61 recession.

Charts 1, 2, and 3 display the recession since last spring as evidenced by important economic series, all seasonally adjusted.

Industrial production, the Federal Reserve index, in January 1961 was off 8 percent from January 1960.

Nonagricultural employment showed a 1½-percent decline from May 1960 to January 1961. Retail sales in constant prices dropped by 7 percent from April to January. Unemployment was up from 5.1 percent of the labor force in May 1960 to 6.6 percent in January of this year. Gross national product (GNP) corrected for price changes was down 1 percent from the second quarter of 1960 to the last quarter.

These magnitudes have been put in chart form on chart 1. Charts 2 and 3 compare the four postwar recessions. I will not go into those in detail, but merely say that the fourth recession has thus far been shallower than its predecessors, but the gentleness of the current decline is small consolation because the descent began from relatively lower levels.

The previous recovery was abortive, and the recession began with an unemployment rate which earlier recessions did not reach for 3 to 6 months.

In the current recession, as in earlier postwar cyclical fluctuations, business inventories have been the principal element of instability. This is discussed in the text of our statement and is summarized in table 1.

The prospects of reversal of the recession in the first two quarters of this year depend on modest advances in components of demand other than inventory change. We do not at the moment see inventory change as a net plus factor for some time to come. A quickening of the pace of recovery following a reversal of the inventory-cycle mechanism does not appear likely until after midyear.

The principal prospects for early expansion of demand lie in the continued upward trend in Government purchase—Federal, State, and local—and in increases in consumer spending with the aid of governmental income-maintenance programs. Net exports cannot be expected to repeat the dramatic gains of 1960.

In the absence of special measures of stimulus, business fixed investment is unlikely to rise above 1960 levels before GNP itself increases significantly. The same is true, in this recession in contrast to 1958, of residential construction. Once GNP rises from other causes, the upswing will be reinforced by upward revision in business and residential investment.

Developments which would weaken final demand cannot be excluded. These include the possibilities (*a*) that consumers will maintain or even increase the abnormally high personal saving ratio of the last half of 1960; (*b*) that business firms will once again revise downward their plans for plant and equipment expenditure; and (*c*) that the deteriorating financial position of State and local governments might interrupt the strong and steady upward trend in their expenditures. If these weaknesses develop, the end of the recession may have to await the rhythm of the inventory cycle.

Whenever it occurs, reversal of the recession is only the beginning, not the end, of the task of restoring momentum to the American economy. Even if GNP in the last quarter of this year were to achieve an all-time record level of 3.5 percent higher than the fourth quarter of 1960—a gain of $18 billion in constant 1960 prices—the unemployment problem would still be of roughly the same magnitude as today.

This sobering statistic dramatizes the challenge and the opportunity presented to us by the continuous expansion of U.S. economic potential.

THE PROBLEM OF CHRONIC SLACK AND FULL RECOVERY

Economic recovery in 1961 is far more than a cyclical problem. It is also a problem of chronic slack in the economy—the growing gap between what we can produce and what we do produce. This is graphically illustrated in charts 4 and 5.

Especially since 1955, the gap has shown a distressing upward trend. At this point I would like to speak briefly from the charts.

Chart 4, entitled "Gross National Product, Actual and Potential, and the Unemployment Rate," shows the way in which the gap between what we have actually produced in the past 8 years and what we could have produced at a normal 3.5-percent increase in potential has developed and broadened over those years.

I should explain that the potential represents this relatively modest increase of 3.5 percent per year in our ability to produce; that is, what the economy is capable of producing at 4 percent unemployment. In other words, the straightline represents a 3.5-percent rate of increase in our ability to produce at 4 percent unemployment, which is our rather conservative definition of full employment.

I might say that because this is a calculation of some importance to the analysis, we have prepared a special supplement, supplement A, which goes into the underpinnings of this 3.5 percent in some detail.

I will explain later, but I think I should mention now, that we do not suggest this as a target for the American economy. We are simply saying that 3.5 percent is the rate at which our present potential grows, both from the rate of increase in the labor force, which is 1.5 percent per year, and the rate of increase in productivity per man, which is 2 percent per year. The derivation of those two figures is described in detail in supplement A.

The line for actual gross national product in this chart represents gross national product in 1960 prices. Of course, both lines are given in stable 1960 prices. If you follow this upper part of chart 4, you find that in the 1954 recession, the gap developed, but closed at the end of the recession in the recovery of 1955, but even before the development of the 1957–58 recession we began to drop off a little from our potential output.

In the 1958 recession the gap developed, but never closed. In fact, at the peak of the recovery last year, we were still about 5 percent below the normal potential of the economy.

At that point, for the year as a whole, the economy produced $503 billion of output when it was capable of producing $535 billion.

If you look at the lower part of the chart, which shows the same relationships and puts them in terms of the interplay of the gap between actual and potential production and the unemployment rate, you will find that at the trough of the 1958 recession the gap between what we did produce and what we should have produced was about 9.5 percent.

In the fourth quarter of 1960, that gap had again grown to 8 percent, and today, in spite of the mildness of the 1960 recession, the gap between actual and potential production, employment and income, is almost as great as it was in the trough of the 1958 recession.

We feel that this is the urgent and significant point about our economic situation today. The mildness of the recession has tended to obscure the seriousness of the gap between our performance and our potential, a $50 billion gap. In other words, we have about $50 billion of unused capacity in the economy today.

Chart 5 I will treat only briefly by saying that it simply tracks the relationship between unemployment and the unused potential gross national product and shows that for every 1 percentage point increase in unemployment there is a decrease of 3 percentage points in gross national product.

For example, if unemployment were cut back from, say, 6.6 to 5.6 percent, this would be associated with an increase of $15 billion in the gross national product.

COMPOSITION OF UNEMPLOYMENT

Some have attributed the growth of unemployment in recent years to changing characteristics of the labor force rather than to deficiencies in total demand. According to this view, the new unemployment is concentrated among workers who are intrinsically unemployable by reason of sex, age, location, occupation, or skill.

Expansion of overall demand, it is argued, will not meet this problem; it can only be met by educating, retraining, and relocating unsuccessful jobseekers.

The facts, which are examined in supplement B, clearly refute this explanation of the rise of unemployment over the last 8 years. Only an insignificant fraction of this rise can be traced to the shift in composition of the labor force. The growth of unemployment has been a pervasive one, hitting all segments of the labor force. Further reference is made in appendix B.

In a free economy as large as ours, a certain amount of frictional unemployment caused by changes in the structure of industry and manpower is unavoidable. In addition, a small fraction of the adult population is unemployable. Yet, there is no evidence that hard-core unemployment has been growing as a percent of the labor force.

Measures to improve the mobility of labor to jobs and of jobs to labor, to better our educational facilities, to match future supplies of different skills and occupations to the probable pattern of future demand, and to improve the health of the population—these are and should be high on the agenda of national policy.

But they are no substitute for fiscal, monetary, and credit policies for economic recovery. Adjustments that now seem difficult, and unemployment pockets that now seem intractable, will turn out to be manageable after all in an environment of full prosperity.

THE PROMISE OF FULL RECOVERY

Restoring the economy to capacity operations, apart from abating the misery and human waste of unemployment, would make impressive contributions to our national economic objections: (*a*) to the fiscal capacity of government at all levels; (*b*) to the flow of capital investment so urgently needed to maintain economic growth and improve the competitive position of American industry; and (*c*) to the welfare of all segments of our population.

Government revenues, particularly those of the Federal Government, are highly sensitive to economic activity. Chart 6 is illustrative of the dependence of Federal budget receipts on gross national product.

Were the economy to operate at full employment levels in 1961, and at comparable rates in the first 6 months of 1962, it is estimated that Federal revenues in fiscal 1962 would be $92 billion.

I should make clear that this chart, labeled "Dependence of Federal Budget Receipts on Gross National Product," is an illustrative estimate. What it attempts to show is that if our economy were working at the full employment or 4 percent unemployment level, that we have taken as our modest target, the revenue system would be producing $92 billion of revenue for the Federal Government. The present tax systm would be producing $92 billion of revenue which would lead to a surplus of around $11 billion over the expenditures proposed by President Eisenhower.

Senator BUSH. What level of the gross national product would that be?

Mr. HELLER. That would be a level of gross national product, according to the scale at the bottom of the chart, of just over $560 billion. As I say, this is a hypothetical table. The particular example that we selected for special emphasis on the chart is not too far from the economy's potential today.

This would exceed the expenditures estimated in the budget message of January 16, 1961, by $11 billion and the revenues by $9.5 billion. Moreover, if the economy grows 3.5 percent per year, the present Federal tax structure will increase budget receipts by $3 to $3.5 billion per year. The revenues of a fully operating economy would finance the Federal programs needed to accelerate the growth of productive capacity and meet national priorities at home and abroad, while leaving room for substantial retirements of Federal debt from the budget surplus.

Economic recovery will also improve the fiancial position of hard-pressed State and local governments. The growth of population and of needs for facilities and services provided by these governments is straining their financial resources. During the last quarter of 1960, these governments were spending at a rate of $4.2 billion above their receipts (on an accrual basis). With full recovery, their receipts would approximately cover their present outlays.

In 1960, business expenditures for new plant and equipment, corrected for price changes, were 9 percent below the levels achieved in 1956 and 1957. Investment in new productive facilities has been falling absolutely. It has fallen even more sharply in relation to actual GNP, let alone to potential GNP. To increase the attainable rate of growth of the economy, we must increase the share of our current potential output that we devote to new investment. Full recovery can make two contributions to this objective. The first is to add the pressure of vigorous consumer demand and resulting profits to the incentive for expansion and modernization of productive facilities. The second is to provide additional savings to finance investment—direct personal saving, retain business earnings, and Government surplus. Corporate profits were about $44 billion in 1960. In a fully operating economy in 1961 corporate profits would be about $58 billion, providing enhanced incentive to undertake investment and greater resources to finance it, as well as more revenue for the Federal Treasury.

I will not read the material between pages 18 and 30, although it contains some of the choicest prose in our entire statement, but merely summarize it as follows:

This section deals with the problem of growth and the problem of our balance of payments. We feel that to maintain a sounder comparison we should talk about the growth of our potential. In the earlier period, the potential grew right along with the actual, 4½ percent. In the later period, 1953–60, the potential grew at 3½ percent, but because of the——

Senator BUSH. What was the earlier period?

Mr. HELLER. 1947–53.

Representative CURTIS. Why do you pick those periods?

Mr. HELLER. These are the periods that represent the peak-to-peak duration of the business cycles in the postwar period.

Representative CURTIS. But you have a war in there.

Mr. HELLER. This is the period that has been used both in economic discussions and analysis both outside and inside the Government.

Representative CURTIS. I regret to say that it has, but I am asking as an economist, can't you distinguish between an economy based on war and one based on peace?

Mr. HELLER. This is a question I am not trying to address myself to at the moment. I am trying to look at the economy in terms of rates of growth that it has shown itself capable of attaining in the early years after World War II and the rates of growth that it has attained in more recent years.

Representative CURTIS. I would like to apologize to the chairman, because I should wait until the end before I question. I withdraw the question.

Chairman PATMAN. In view of the situation, it is all right. Each member will be allowed to question the witnesses.

Representative CURTIS. I should wait.

Mr. HELLER. I note, by the way, that this period was also used in President Eisenhower's Economic Report.

Representative CURTIS. That makes no difference to me. I am trying to aproach this as to why an economist should not distinguish between a war economy and a peacetime economy.

Mr. HELLER. I assume we will have a chance to discuss that further in the questioning period.

I might address just a few words to the causes of this slowdown in growth. First, we find in reviewing the facts that the increase in the stock of our plant and equipment per worker has slowed down since 1955. In the same period, the average age of equipment has crept up from 8.5 years to 9 years, and this has been one of the factors in the slowdown in our rate of growth and productivity.

This does not have any particular relationship either to wartime or peacetime operation. The fact of the matter is that our equipment has been growing older instead of younger at the rate of investment that has been undertaken in recent years.

Secondly, of course, in the long run, the productivity potential won't grow faster than the demand for output. The best stimulus to

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capital expansion is pressure on present capacity. That has been noticeably lacking in most industries in recent years. Available data on relationship of output to capacity shows that we are operating our industrial plant at less than 80 percent of capacity at the present time.

With respect to the material on pages 26 to 30, we there reviewed the developments in the balance of payments, specially as they may be affected by economic recovery at home. Of course, the Secretary of the Treasury will testify on this subject at more length tomorrow. It has this significance, however, in relation to expansionary economic policy. Many people fear that expansionary economic policy will substantially worsen our balance-of-payments position. It is true that brisk recovery would increase imports relative to exports, which is on the minus side as far as the balance-of-payments position is concerned. But it will also tend to keep more investment at home by making business more profitable here. It will increase earnings on past foreign investments that come back to this country, and it perhaps will draw more foreign investments to the United States. Together with the moves that the administration is making to conserve foreign expenditures, the recovery process need not worsen our balance-of-payments position.

After some explanation of the question of whether we have priced ourselves out of world markets, and the question of private investments abroad we conclude: The United States still enjoys great competitive power and financial strength.

III. Economic Policy

In this section, we shall discuss major governmental policies to reverse the recession, achieve full recovery, and promote growth. By focusing on governmental policies, we do not intend to suggest that recovery and growth depend exclusively—or even primarily—on the Government. The prosperity and progress of a free society depend principally on the enterprise and skill of private citizens. The Government seeks to strengthen the forces of recovery and growth in the private economy.

MONETARY POLICY AND DEBT MANAGEMENT

In this recession, for the first time since 1931–32, expansionary monetary policy has been limited by the international financial position of the United States. Over the past 6 months our balance-of-payments deficit has been severely aggravated by the outflow of short-term capital attracted by higher short-term interest rates abroad. To stem the outflow, Federal Reserve authorities have had to limit expansion of money and credit, especially in recent months, to keep short-term interest rates from falling too far. Short-term rates have remained 1.5 to 2 percentage points above past recession levels. The Federal Reserve discount rate, which fell as low as 1.75 percent in the 1958 recession, is 3 percent today. The Treasury bill rate reached 0.6 percent in May 1958 but stands at 2.6 percent today, up from its recent low of 2.1 percent in November 1960.

Long-term rates have been very sticky. The "prime rate"—the rate New York banks charge their prime-risk customers for commercial loans—is 4.5 percent now, in comparison with 3.5 percent in 1958 and 3 percent in 1954. Corporate Aaa bonds yield 4.2 percent now, in comparison with 3.6 percent and 2.8 percent in the two preceding cyclical troughs.

The Federal Reserve has recently announced that it is purchasing long-term U.S. Government securities on the open market. The new policy is an extension of its efforts to provide additional reserves by purchases that do not directly depress the short-term rate. The objective is to lower long-term interest rates, in order to increase business investment and residential construction, while maintaining the discount rate and related short-term rates at internationally competitive levels. Treasury public debt operations are also geared to this objective. Federal Reserve and Treasury operations may be expected to result in reduction of the stock of long-term bonds available to private investors, relative to the outstanding supplies of short securities. The extent to which the maturity structure of rates can be "twisted" by these operations remains to be seen. But the experiment must be tried. The domestic economy urgently needs the stimulus of lower effective long-term and commercial rates. At the same time, as confidence in the dollar is restored and as interest rates aboard continue to fall, the constraint on our short-term rate can safely be relaxed.

The economy needs the stimulus of low interest rates and greater credit availability, not merely for recovery of the ground lost in the recession but for the more difficult and important tasks of restoring full employment and promoting growth.

HOUSING CREDIT

Credit policy affects many families directly through its impact on the mortgage market.

Private housing starts have been declining for nearly 2 years. Inventories of unsold new houses are significantly higher than in early 1959. In the three previous postwar recessions, revived strength in housing activity operated to sustain the economy; in the current recession, this has not been the case.

The present weakness in housing construction is in part a legacy of the high level of building activity in 1958–59. It is also, in part, a consequence of demographic factors; because of low birth rates in the 1930's, the number of persons reaching the average age of first marriage in the last few years has been temporarily low. Private housing starts reached an annual rate, seasonally adjusted, of 1.6 million in April 1959, then declined to 980,000 in 1960. A recovery to 1.1 million occurred in January 1961.

This is not, however, the whole story. Residential construction has been further depressed by high interest rates on mortgages. It is difficult to accept the view that the housing market is so glutted that it would not respond to lower monthly financing costs. The possibilities for such reduction through lower interest rates are substantial; for example, a reduction of 1 percent in the rate of interest on a 30-year mortgage could reduce monthly mortgage payments by more than 10 percent.

Mortgage interest rates are sticky prices. Though availability of mortgage funds improved in 1960, interest rates responded only sluggishly. The average decline was less than one-fourth of 1 percent. In the face of a depressed level of homebuilding activity, rising liquidity in many lending institutions, and a continuing decline in long-term interest rates generally, the cost of housing credit should have fallen more sharply. Mortgage interest rates of 6 to 7 percent are out of touch with the realities of 1961.

The administration has taken a number of steps to hasten the decline in mortgage lending rates. The maximum permissible interest rate on FHA-insured loans has been reduced. The FNMA, in its secondary market operations, has increased both its selling prices and its buying prices for mortgages. At current FNMA selling prices, most lenders will find it more attractive to seek other investments than to buy existing mortgages from FNMA. The search for other investments will help, directly or indirectly, to push down interest rates on new mortgages.

The Federal Home Loan Bank Board has assisted the administration's effort to stimulate housing construction and lower the cost of housing credit by a number of revisions in its policies and regulations. Also, the President has requested the Chairman designate of the FHLBB to meet with leaders in the savings and loan field and to urge them to reduce mortgage rates.

Further measures to stimulate housing demand will become possible as general monetary conditions are further eased.

FISCAL POLICY

The Federal budget serves as an important stabilizing force in our economy. In part, this force is exerted through the rhythm of automatic changes in tax receipts and transfer payments as incomes rise and fall. In part, it is the result of conscious changes in tax and expenditure programs. For example, taxes were reduced several billion dollars in 1954 through scheduled expirations of certain taxes and new legislation; expenditures were increased several billion dollars in 1958 by expansion and acceleration of Government programs. In recent years, revenues have risen and expenditures have fallen slightly as a percentage of gross national product. As a result, both the automatic cycle of the budget and the impact of legislative changes revolve around a higher ratio of revenues to expenditures than was formerly the case.

Chart 7 is on a national income accounts basis, and does not relate directly to the budget or consolidated cash basis. It is assimilated to the national income accounts.

As demonstrated in chart 7, the combination of automatic and discretionary budget forces has generated substantial surpluses in prosperity and deficits in recession. There is wide consensus that the surpluses have been helpful in restraining inflation, and the deficits in cushioning recession and promoting recovery. This is not to say that either the size or the timing of budget changes have been perfectly fitted to the movement of the business cycle. But by and large, the fiscal system has served as an important stabilizing influence.

Three important characteristics of the automatic responses of the budget should be noted, especially as they bear on the current recession and the outlook for recovery. First, under present conditions and tax rates, the "built-in" flexibility of the Federal budget offsets between 25 and 30 percent of the drop (or increase) in GNP in cyclical changes with approximately one-half of the offset coming from corporate taxes, one-quarter from personal income taxes, and most of the rest from the various social security programs. As chart 6 illustrates, Federal receipts alone decline $3.4 billion for every 1 percent increase in the rate of unemployment.

Second, welcome as the built-in stabilizers are when the economy contracts, they are a mixed blessing when it expands. As soon as business conditions take a turn for the better, we can expect the Federal tax system automatically to cut into the growth in private incomes. When the economy again reaches the boom phase, this drain on private incomes will serve as a desirable restraint on inflation. But up to that point, it tends to slow down the recovery process.

Third, because economic growth automatically broadens the tax base, the revenue-raising power of the Federal tax system has been rising relative to expenditures. Indeed, tax revenues—even at stable tax rates—rise more than proportionately to GNP. Table 6 drives home this point. At roughly comparable phases of business activity—8.9 percent below potential in the first quarter of 1958 and 7.7 percent below potential in the fourth quarter of 1960, and in both cases prior to the impact of active antirecession measures—the deficits were vastly different. In the first quarter of 1958, the deficit was running at an $8 billion annual rate. Last quarter it was less than $1 billion. In other words, the relative growth of revenues in recent years brings the budget into balance substantially below full employment at current levels of Federal expenditures and tax rates. In the absence of tax cuts, large expenditure increases, or a substantial worsening of the economic situation, only modest deficits are likely to develop.

Deficits as large as those experienced in the 1958 recession could materialize in the current recession only if unemployment and unused potential grew substantially larger than they were at the bottom of the 1958 recession, or if a very much greater expansion of Government programs than now contemplated were undertaken. Indeed, recent fiscal trends make clear that full recovery with the present tax structure would generate substantially more revenue than is required by the President's proposed programs, thus leaving a generous margin for retirement of debt and restraint of inflation. Whether this margin is consistent with the achievement and maintenance of full employment cannot yet be determined.

In his program to restore momentum to the American economy, President Kennedy announced Executive action and recommended legislation to help reverse the decline and set the American economy on the road to recovery. Since that time, the President has also proposed programs in education, health, natural resources, and highways, which, while fully justified on their own merits, promise additional benefit in the form of speedier recovery. The exact cost of all these programs, their timing, and their impact on the 1961 and 1962 Budget and on receipts from and payments to the public—the consolidated cash budget—are not yet known. A review will be undertaken by the Director of the Budget in his appearance before the Joint Economic Committee later this month.

However, the costs of the largest programs are already known. It may be useful to the committee to appraise in general terms the economic impact of these programs as they relate to the problems of recession and recovery. For this purpose, we have estimated the overall magnitude of the programs. However, this estimate does not refer to budget expenditures, for two reasons.

First, it is an estimate of the impact of the programs in the income and product account. Unlike either the budget or consolidated cash accounts, the income and product data are assimilated directly to the GNP accounts and are shown, to the extent possible, on a current—accrued—basis. These accounts diverge from the conventional and cash budget figures. Moreover, some of the President's recommendations, like the improvement in old-age, survivors, and disability insurance, affect only the trust accounts and thus are reflected in the income and product account without any direct effect on the conventional budget.

Second, the times of enactment of the various programs are uncertain. Some programs are likely to be enacted very quickly, for example, temporary unemployment compensation, and will therefore still affect the fiscal 1961 budget, while others will not take effect until fiscal 1962. To simplify matters, we have put all the available calculations on the same basis by making the assumption—unrealistic but adequate to our present purpose—that all the recommended legislation is enacted at the same time.

The calculation shows that the President's program would generate an estimated flow of at least $3 billion to consumers and business during the first 12 months after enactment. This estimate includes only programs for which costs have already been made public: temporary unemployment compensation, aid to dependent children, OASDI changes, area redevelopment, aid to education, and several smaller programs. It omits such items as advanced procurement, speedup in funded public works, and proposals that may be developed in the field of housing. Further, it does not include the impact of such additional defense expenditures as may prove to be necessary for national security.

Even if this estimate included all of the President's proposals, it would not measure the full stimulative effect of the administration program. First, only the primary effects are measured, leaving out the further expansionary effects as funds are spent by the recipients. Second, acceleration of construction and contract letting may not be reflected in the Government's income accounts for a long time but may have immediate stimulative effects on the inventory, employment, and equipment needs of the contractors. Third, the nonbudgetary programs—notably the move to reduce interest rates and increase credit availability—can have important stimulative effects.

The President said in his February 2 message, "If economic developments in the first quarter of this year indicate that additional measures are needed, I will promptly propose such measures." Any such measures will, of course, have substantial fiscal impacts. A further program for economic recovery might consider a speedup in Government construction and related projects, an expansion of housing programs, and tax reduction.

If a new reading of the economic and fiscal situation indicates that additional measures are needed, a temporary income tax reduction offers one of the most important methods for further economic stimulus. It offers a method of stimulating the economy quickly and effectively, at the same time preserving the basic revenue-raising power of the tax system for later use in financing Government programs and stemming inflation through debt retirement and so forth. The beneficiaries of a personal income tax cut, especially in the lower brackets, would promptly spend a large part of the proceeds on goods and services, thereby stimulating production, employment, and income.

In appraisal of the usefulness of expanding Government expenditures in promoting recovery, the timing of their impact is often considered to be of decisive importance. This may be the case in a recovery which starts from a position not far below the economy's full potential. In such a recovery there is a danger that the impact of low-starting Government projects comes too late to aid the recovery but instead aggravates an inflationary boom. The present situation is not of this kind. The decline began from a position of substantial unemployment and excess capacity. We face a stubborn problem of chronic slack, and the road to full recovery is a long one. The expansionary effects of Government programs will be welcome even if they occur well after the recession has been reversed.

In the spring and summer of 1958, the delayed impact of new expenditure programs may have appeared to be a real danger. Output was rebounding rapidly, and the outlook for housing was bright. As it turned out, fears of perverse timing were unnecessary, because the recovery was abortive. With that incomplete recovery behind us, the problem of chronic slack is more clearly evident today. Also, the outlook in housing—which played such an important role in recovery from the 1949, 1954, and 1958 recessions—is much less encouraging in 1961. Thus, the risk of bad timing of Government outlays is smaller in 1961 than it was appeared in any previous postwar recession. In our present circumstances we should not shrink from launching needed projects because of misplaced fears of bad timing.

The success of fiscal and budget policies cannot be measured only by whether the budget is in the black or in the red. The true test is whether the economy is in balance. Only an economy which is realizing its potential can produce the goods and create the jobs the country needs. If at the end of this year the unemployment ratio is still near 7 percent, our fiscal policies would have to be viewed with great concern, even if there is little or no deficit in the budget. On the other hand, if we have succeeded in reducing the unemployment ratio and expanding output significantly by year's end, we will be on our way to the goals of a stronger economy and the restoration of budgetary strength.

POLICY FOR GROWTH

For the near future, economic policy justifiably places first emphasis on measures to expand aggregate demand to levels that will overcome the recession and, in time, close the gap between actual and potential production. Since demand pushing hard on existing capacity stimulates investment in plant and equipment, measures for economic recovery form an essential part of a balanced program for economic growth. But at high levels of activity, the major emphasis of growth policy is necessarily focued on the uses of our output; that is, on the channeling of a larger share of our resources to the expansion and improvement of both the human skills and the physical capital of the country.

A basic component of any program for accelerated economic growth must be investment in the extension of knowledge, the general education of the population, and the training of the labor force. The improvement of technology and the increase of skills go hand in hand with ordinary capital formation to increase productive capacity. Their interaction is far more powerful than the sum of their independent effects.

Effective translation of advances in knowledge and technology into advances in the quantity and quality of output requires additional business investment. As noted earlier, the fraction of our GNP devoted to investment in plant and equipment has been declining since 1948. If we choose as a nation to accelerate our rate of economic growth and productivity increase, we must reverse the tendency of our capital stock to age. This will require an increase in the rate of investment relative to GNP, perhaps beyond the levels of early postwar years. Some of this investment will be for expansion of capacity and some to give effect to technical progress and potential increase in productivity.

The revenue-raising power of the existing Federal tax system can be an important asset in achieving the levels of investment needed for rapid advance in productive capacity. First, the potential high-employment surplus can be used, as discussed above, to finance the desirable Government programs which contribute to the buildup of human capital. Second, it can indirectly increase incentives for private investment by facilitating a policy of relative monetary ease, as noted in the preceding section. Third, it can be placed at the disposal of the economy for investment purposes by the process of debt retirement. When the Federal Government retires debt it, in effect, exchanges cash for an asset which had been a store of wealth for the owners of the debt. These owners then seek other assets to hold, primarily the debt and equity securities of business firms and the bonds of State and local governments. In other words, the debt retirement process channels savings into uses which facilitate investment for economic growth.

In addition, the tax system can be used to provide specific financial incentives for investment. In his economic massage, the President announced that we would propose a modification of the income tax law to favor investment in plant and equipment. This can be done in such a way as to yield strong incentive effects per dollar of revenue loss. Accompanying measures would restore the revenue loss and improve the fairness of the tax system.

Measures to stimulate business investment directly will contribute to our recovery from the present recession, but that is not their main purpose. All who have confidence in the American economy must look ahead to the day when the slack will be taken up and high levels of output and employment will again be the rule. The full benefit of our decision to supplement increases in consumer demand now with a higher rate of capital expansion and modernization will then be realized.

PRICE STABILITY

In his economic message of February 2, the President said:

> We must not as a nation come to accept the proposition that reasonable price stability can be achieved only by tolerating a slack economy, chronic unemployment and a creeping rate of growth.
>
> Neither will we seek to buy short-run economic gains by paying the price of excessive increases in the cost of living. Always a cruel tax upon the weak, inflation is now the certain road to a balance-of-payments crisis and the disruption of the international economy of the Western World.

The task of reconciling full recovery and accelerated growth with reasonable price stability carries an urgency which justifies the emphatic tone of the President's language. The work of the Joint Economic Committee has been of major importance in extending awareness that inflation in America is not one problem but many, and that there is no single easy formula for achieving the reconciliation we all seek.

As we look ahead to the price problems of the next few years, the following considerations will contribute to a clearer appreciation of the issues.

1. By far the greater part of the postwar inflation occurred in two periods of overall excess demand—the years 1946–48, and the period of the Korean conflict. If the problem should recur in this form, the powerful tools of fiscal and monetary policy are available, and will be used, to bring aggregate supply and demand into balance.

2. The inflation of the years 1955–58 cannot be characterized by any single label. Some price and wage increases in those years were delayed reactions to the earlier demand inflations. Others were compounded of temporary excess demand in some sectors, slow response of productive sources to secular shifts in demand, sluggish productivity gains in some industries, and the exertion of market power by some elements of labor and management.

3. The goal of reasonable price stability does not mean that no price should rise. It does mean that price increases for some goods and services, necessitated by smaller than average productivity gains or other causes, must be roughly balanced by price reductions of other goods or services, made possible by larger than average productivity gains or other factors. Moreover, price level stability is not the equivalent of absolute stability in the official price indexes; as noted in the "Report of the Price Statistics Review Committee," which the Joint Economic Committee has just published, many experts believe that the price indexes by failing to take full account of quality improvement, contain a systematic upward bias.

To create a climate which will reduce the likelihood of a repetition of the 1955–58 experience, public and private policy should focus on several objectives:

First, the forces of competition should be strengthened by the vigorous enforcement of the antitrust laws and by other appropriate means. Some excessive price increases in 1955–58 might not have occurred if market control had not been so strong.

Second, continuing effort should be made to enlist the cooperation of labor and management in a voluntary program of price and wage restraint. In this connection, the President has appointed an Advisory Committee on Labor Management Policy which will concern itself, among other things, with actions that may be taken by labor, management, and the public to promote sound wage and price policies.

Third, a higher rate of productivity increase should be sought, not only for the direct benefits which higher productivity will yield, but also because a highly progressive economy is able to absorb steadily rising wage rates into a stable price level. The President's Labor-Management Committee will also seek to achieve agreement on methods of raising productivity.

Fourth, efforts should be made to foresee emerging needs for skilled manpower, to aid in the adaptation of skills to present and prospective demands, and to promote geographical and occupational mobility. For example, because the supply of medical services has not responded adequately to a steady increase in demand, sharply rising costs of medical care have contributed to the increase in consumer prices. In this connection, the President has proposed legislation to support the expansion of medical and dental education facilities and, through a program of scholarships, to increase the number of new doctors and dentists graduated each year. Studies are also underway looking toward the modernization and redirection of the National Vocational Education Act. Programs of this sort, modest though they may be, can increase the resiliency and efficiency of the economic system and strengthen its resistance to price increases.

IV. Summary and Conclusion

As we review the state of the economy and the policies for recovery and growth, these points stand out:

1. The recession itself, while not as severe as the other three postwar recessions, has proceeded steadily since last spring. Current hopes for an economic upturn lie principally in a possible rise in consumer spending aided by the stimulus of the President's programs; the continued upward trend in local, State and Federal Government purchases; and some prospect of an assist from inventories within several months.

2. An economic upturn would be only the beginning, not the end, of the solution to our economic problems. The recession followed an incomplete recovery in which the American economy fell substantially short of its potential levels of employment, production, and income. Indeed, the gap between what we are producing and what we can produce reached 8 percent at the end of 1960. Today, it may be even closer to the 10 percent gap that developed at the worst stage of the 1958 recession. Taking up this slack of some $50 billion in economic activity, rather than merely reversing the economic decline, is the real challenge of economic policy in the months ahead.

3. In addition to the problems of recession and slack, we are confronted with a disturbing slowdown in the rate of growth of our national economic potential. The rate at which the stock of the country's capital has been expanded and modernized has slowed down

in the face of unused capacity, with a consequent slackening of growth in productivity. Also, we have not made full use of possibilities for increased investment in human capital through education, training, and research.

4. The risk of bad timing of Government outlays—in the sense that antirecession projects may have a delayed impact which will aggravate an inflationary boom—is smaller in 1961 than it has appeared in any previous postwar recession. Given the continued and stubborn problem of economic slack—and given the less encouraging outlook for the housing sector, which played such a major role in the early phase of the 1958 recovery—one can only conclude that we must not shrink from launching needed projects because of misplaced fears of bad timing.

5. Substantial opportunities exist in the field of monetary policy, debt management, and housing credit to contribute to economic recovery and growth. The Federal Reserve and the Treasury are pursuing policies to reduce the cost and increase the flow of long-term credit while keeping short-term interest rates from falling to levels which would lead to further withdrawals of short-term capital. With the support of the general measures to lower the cost of long-term credit, specific steps are being taken to lower mortgage rates and increase the availability of funds to homebuilders.

6. The President's programs, which promise substantial support to consumer income and demand, can be a major factor in strengthening the American economy in the months ahead. However, the President, in his February 2 message, stated:

> If economic developments in the first quarter of this year indicate that additional measures are needed, I will promptly propose such measures.

A further program for economic recovery might consider a speedup in Government construction and related projects, an expansion of housing programs, and tax reduction. Temporary income tax cuts, in particular, provide a fast method for enlarging the private income stream and speeding recovery. At the same time, the temporary nature of such a tax reduction would preserve the basic revenue-raising power of the tax system for later use in financing Government programs, retiring debt, and stemming inflation. Whether such additional stimulative measures will be needed depends, as the President has indicated, on further economic developments.

7. In pursuing the expansionary policies required by the serious economic problems we face, we cannot lose sight of the possible impact of those policies on domestic price levels and our balance of payments. We do not accept the gloomy doctrine that economic expansion is inherently inconsistent with reasonable price stability and balance in our international accounts. For example, added investment to stimulate increases in productivity, with consequent reductions in cost, simultaneously serves all three objectives. In addition, the work of the President's Advisory Committee on Labor-Management Policy gives promise of improvement in public and private policy for maintaining price stability.

8. Together with policies to reverse the recession, close the employment and production gap, and maintain reasonable price stability, it

is important to initiate further steps to promote faster economic growth. These would include tax incentives to stimulate business investment and expanded programs in education, training, and research to build up America's human capital.

The foregoing considerations underscore the importance of the economic goals placed before the Nation in the President's February 2 message to the Congress:

> Realistic aims for 1961 are to reverse the downtrend in our economy, to narrow the gap of unused potential, to abate the waste and misery of unemployment, and at the same time to maintain reasonable stability of the price level. For 1962 and 1968 our programs must aim at expanding American productive capacity at a rate that shows the world the vigor and vitality of a free economy. These are not merely fond hopes, they are realistic goals. We pledge and ask maximum effort for their attainment.

Thank you.

(Mr. Heller's prepared statement follows:)

THE AMERICAN ECONOMY IN 1961:
PROBLEMS AND POLICIES

Statement of the Council of Economic Advisers
(Walter W. Heller, Chairman; Kermit Gordon; James Tobin)
Before the Joint Economic Committee
Monday, March 6, 1961

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Statement of the Council of Economic Advisers
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Mr. Chairman and Members of the Committee:

We have looked forward with genuine pleasure to this first appearance before the Joint Economic Committee. The Committee's studies and reports are among the references most frequently used by the Council--and indeed by the economics profession and by business--as a source of economic information, analysis and wisdom. We sincerely hope that we can continue to benefit from and perhaps contribute to the high standards of research and investigation to which the Committee and its subcommittees have adhered.

The submission of a prepared statement by the Council to the Committee is, to the best of our knowledge, without precedent. Indeed, this is the first time since enactment of the Employment Act of 1946 that a Council has testified before the Joint Committee on the occasion of a change of administration. In all previous years--save 1953, when Council operations were temporarily suspended--the Council could, in effect, let the annual Economic Report serve as its statement on economic conditions and policy. We are not in this position.

We do not mean to suggest that our written statement can serve as a fully developed Economic Report; there have been, after all, only 44 working days since January 20--including Saturdays and Sundays. Nevertheless, a new President has taken office, and an Administration has been organized which looks at our economic problems in a new perspective. Accordingly, we have felt under obligation to present to this Committee a reasoned and fairly lengthy statement of the Council's views.

In our testimony today, we first examine briefly with you the role of the Council as we conceive of it. Second, we review the serious problems of recession, chronic slack, and inadequate growth rates in the American economy today. Because of the length of our analysis, we will ask that some of this material be handled by reference rather than by a full reading before the Committee. Third, we examine the broad lines of policy that are appropriate to the current problems of the economy, particularly in terms of the program which the President has announced in his State of the Union Message and his Message of February 2, "Program to Restore Momentum to the American Economy."

We shall discuss with candor the problems and prospects of the American economy, neither minimizing its difficulties nor underestimating its capacity to overcome them. Workers, consumers, and businessmen would surely not gain confidence in the future of the economy from official reassurances that plainly contradict or ignore their every-day experiences and observations. Economic confidence will be better sustained by evidence that the government assesses real problems soberly and attacks them resolutely. The public will in the long run have confidence in the government only if the government shows confidence in the public.

I. THE ROLE OF THE COUNCIL OF ECONOMIC ADVISERS

On the occasion of the first appearance of this Council before the Joint Economic Committee, we wish to express some general principles that we hope will guide our future relationships with the Committee.

They have no special relevance to the particular subject matter of our first testimony, but are designed to set the stage for what we hope will be a period of mutual understanding and constructive cooperation between the Council and the Committee.

1. The Council has a responsibility to explain to the Congress and to the public the general economic strategy of the President's program, especially as it relates to the objectives of the Employment Act. This is the same kind of responsibility that other Executive agencies assume in regard to programs in their jurisdictions.

2. It is not appropriate or necessary for the Council to go into the details of legislative proposals or of administrative actions which fall primarily in the domain of operating Executive departments or agencies, who can and do testify before the appropriate committees. Our concern is with the over-all pattern of economic policy.

3. The program of the President is, of course, the outcome of a decision process in which advice, recommendations, and considerations of many kinds, from many sources, inside and outside the Executive, play a part. The professional economic advice of the Council is one element; it is not and should not be the sole consideration in the formulation of Presidential economic policy, or of Congressional policy.

4. In Congressional testimony and in other public statements, the Council must protect its advisory relationship to

the President. We assume that the Committee does not expect the Council to indicate in what respects its advice has or has not been taken by the President, nor to what extent particular proposals, or omissions of proposals, reflect the advice of the Council.

5. Subject to the limits mentioned, members of the Council are glad to discuss, to the best of their knowledge and ability as professional economists, the economic situation and problems of the country, and the possible alternative means of achieving the goals of the Employment Act and other commonly held economic objectives. In this undertaking, the Council wishes to cooperate as fully as possible with the Committee and the Congress in achieving a better understanding of our economic problems and approaches to their solutions.

6. The Council is composed of professional economists. But economic policy, as the Committee well knows, is not an exact science. The Council is, and necessarily must be, in harmony with the general aims and direction of the President and his Administration. A member of the Council who felt otherwise would resign. This general harmony is, of course, consistent with divergences of views on specific issues.

We should also note that the President has expressed his intention to "return to the spirit as well as the letter of the Employment Act of 1946," and to have the economic reports "deal not only with the

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state of the economy but with our goals for economic progress." (News conference, December 23, 1960) The Committee will find this desire reflected in today's testimony and in future Council reports as well.

Further, the President has stated that we should not "treat the economy in narrow terms but in terms appropriate to the optimum development of the human and natural resources of this country, of our productive capacity and that of the free world." To carry out these larger responsibilities, the President asked the Chairman of the Council, "to find ways and means of providing us with the best possible staff assistance and advice." We hope that it will be possible to restore the Council staff at least to its size of eight or ten years ago so that the Council will be in a position to meet its full responsibilities as envisioned by the President and the Congress.

II. STATE OF THE ECONOMY

In spite of great inherent strength, the American economy today is beset not only with a recession of nearly 10 months' duration but with persistent slack in production and employment, a slowdown in our rate of growth, and pressure on our international balance of payments.

Recession and Current Outlook

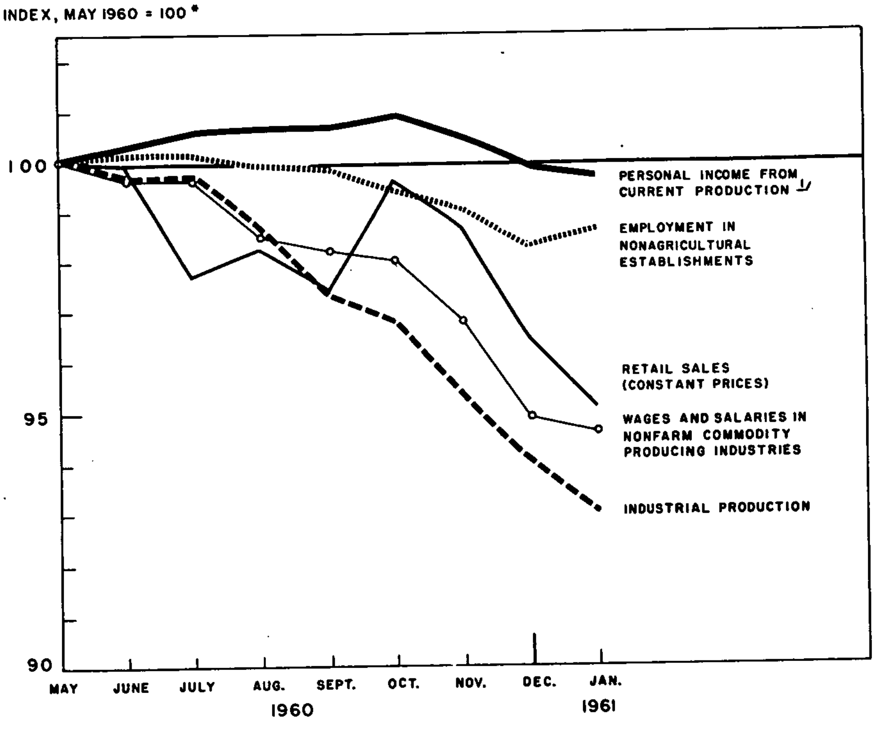
The fourth postwar recession of economic activity in the United States began last spring. May 1960 is generally taken as the peak month, although some cyclical measures began to fall earlier and some later. Charts 1, 2, and 3 display the recession since last spring as evidenced by important economic series (all seasonally adjusted). Industrial production--the Federal Reserve index--in January 1961 was off 8 percent from January 1960. Nonagricultural employment showed a 1-1/2 percent decline from May 1960 to January 1961. Retail sales in constant prices dropped by 7 percent from April to January. Unemployment was up from 5.1 percent of labor force in May 1960 to 6.6 percent in January of this year. Gross national product (GNP) corrected for price changes was down 1 percent from the second quarter of 1960 to the last quarter.

Charts 2 and 3 compare the four postwar recessions. The fourth recession has thus far been shallower than its predecessors. But the gentleness of the current decline is small consolation, because the descent began from relatively lower levels. The previous recovery was abortive, and the recession began with an unemployment rate which earlier recessions did not reach for 3 to 6 months.

In the current recession, as in earlier postwar cyclical fluctuations, business inventories have been the principal element of instability. In the upswing of an inventory cycle, business firms build up their stocks to adjust them to rising levels of output and sales. When output and sales level off, inventory building slackens or ceases. Unless inventory expansion is promptly replaced by increased final demand, production falls.

Chart 1

Selected Indicators of Recession, 1960-61



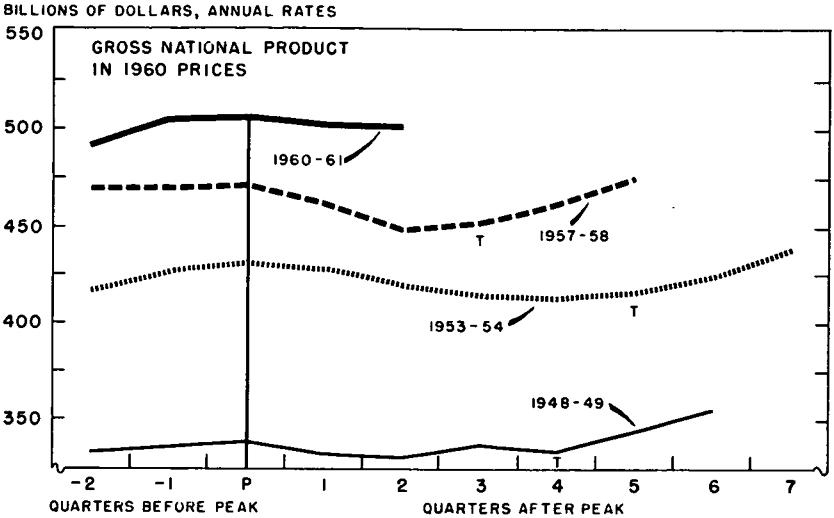
* BASED ON SEASONALLY ADJUSTED DATA.

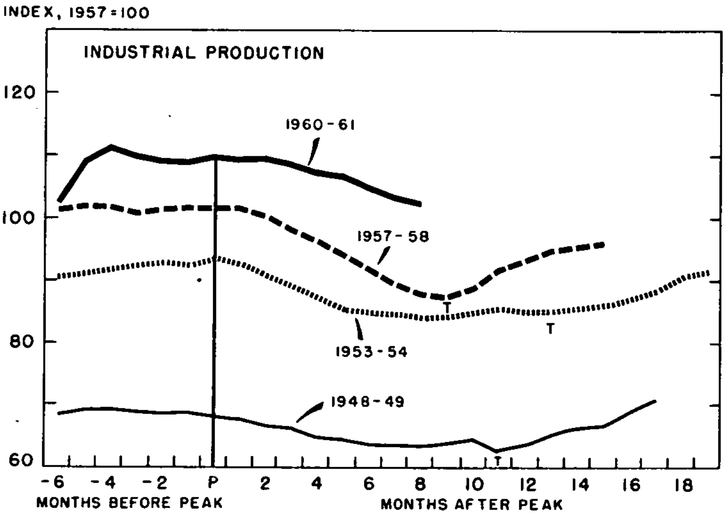
1/ PERSONAL INCOME LESS TRANSFER PAYMENTS AND NET INTEREST PAID BY GOVERNMENT.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND FEDERAL RESERVE.

Chart 2

Production in Four Postwar Recessions





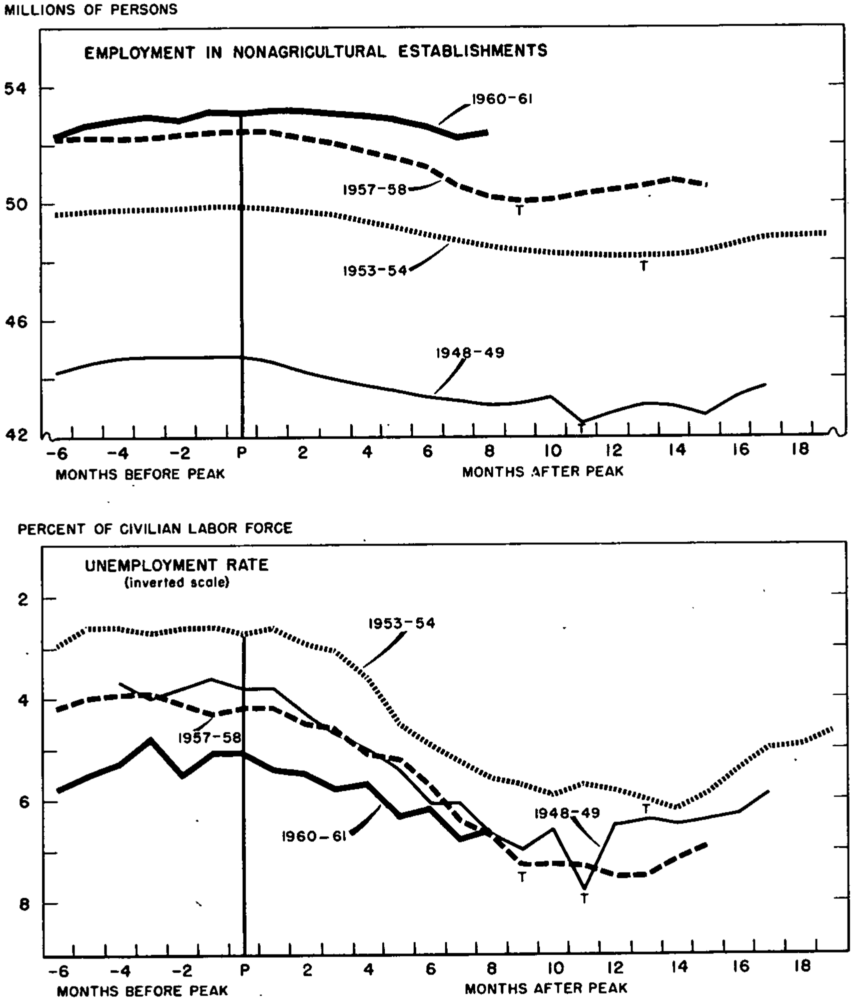
P = CYCLICAL PEAK.
T = CYCLICAL TROUGH.

NOTE: DATA ARE SEASONALLY ADJUSTED AND ARE PLOTTED FROM 2 QUARTERS (6 MONTHS) BEFORE CYCLICAL PEAK TO 2 QUARTERS (6 MONTHS) AFTER CYCLICAL TROUGH.

SOURCES: DEPARTMENT OF COMMERCE AND FEDERAL RESERVE.

Chart 3

Employment and Unemployment in Four Postwar Recessions



P = CYCLICAL PEAK.
T = CYCLICAL TROUGH.

NOTE: DATA ARE SEASONALLY ADJUSTED AND ARE PLOTTED FROM 6 MONTHS BEFORE CYCLICAL PEAK TO 6 MONTHS AFTER CYCLICAL TROUGH.

SOURCE: DEPARTMENT OF LABOR.

Downward adjustment of stocks then leads to further contraction. Once again inventories pursue output and sales, this time downhill. When inventories have caught up, the economy gets a lift just from the substitution of new production for inventory withdrawals.

In the present case, the reversal of business inventory change from plus $11.4 billion (annual rate) in the first quarter of 1960 to minus $3.0 billion in fourth quarter was a reduction of $14.4 billion in demand. Table 1 shows how this reduction was offset by changes in other components. In current prices the $14.4 billion was more than matched by a $16.6 billion increase in other sources of demand. But in constant (1960) prices, the offsets were only $10 billion. Increases in government purchases and

Table 1. Changes in Components of Gross National Product from First Quarter to Fourth Quarter 1960

(Billions of dollars, seasonally adjusted annual rates)

Component	Current prices	1960 prices
Change in business inventories........	-14.4	-14.4
Offsetting expenditure components:		
Gross private fixed investment.....	1.1	1.1
Personal consumption expenditures..	7.5	3.5
Government purchases..............	4.6	1.9
Federal........................	1.5	-.4
State and local................	3.1	2.4
Net exports......................	3.4	3.5
Total offsetting components...	16.6	10.0
Change in gross national product......	2.2	-4.4

Source: Department of Commerce.

net exports have been the principal reasons for the shallowness of the recession. Consumption rose in absolute terms, but it fell in proportion to disposable income. Disposable income grew at an annual rate of $8.9 billion more than GNP, thanks mainly to increases in government transfer payments and decreases in government receipts.

It is always difficult to know when an inventory decline has run its course and to judge where current inventories stand compared with normal ratios to sales. At present, the short-run inventory cycle is superimposed on a longer-run trend towards lower stocks growing out of more efficient management. It would be surprising if inventory liquidation in the fourth quarter of 1960 had been sufficient to adjust stocks to current levels of output and sales. If the patterns of the three previous recessions are repeated, further inventory liquidation would be expected unless GNP rises from other causes. The prospects of reversal of the recession in the first two quarters of this year depend, therefore, on modest advances in components of demand other than inventory change. A quickening of the pace of recovery following a reversal of the inventory-cycle mechanism does not appear likely until after midyear.

The principal prospects for early expansion of demand lie in the continued upward trend in government purchases--Federal, State, and local--and in increases in consumer spending with the aid of governmental income-maintenance programs. Net exports cannot be expected to repeat the dramatic gains of 1960. In the absence of special measures of stimulus, business fixed investment is unlikely to rise above 1960 levels before GNP itself increases significantly. The same is true, in this recession in contrast to 1958, of residential construction. Once GNP rises from other causes, the upswing will be reinforced by upward revision in business and residential investment.

Developments which would weaken final demand cannot be excluded. These include the possibilities (a) that consumers will maintain or even increase the abnormally high personal saving ratio of the last half of 1960, (b) that business firms will once again revise downward their plans for plant and equipment expenditure, and (c) that the deteriorating financial position of State and local governments might interrupt the strong and steady upward trend in their expenditures. If these weaknesses develop, the end of the recession may have to await the rhythm of the inventory cycle.

Whenever it occurs, reversal of the recession is only the beginning, not the end, of the task of restoring momentum to the American economy. Even if GNP in the last quarter of this year were to achieve an all-time record level 3.5 percent higher than the fourth quarter of 1960--a gain of $18 billion in constant (1960) prices--the unemployment problem would still be of roughly the same magnitude as today. This sobering statistic dramatizes the challenge and the opportunity presented to us by the continuous expansion of United States economic potential.

The Problem of Chronic Slack and Full Recovery

Economic recovery in 1961 is far more than a cyclical problem. It is also a problem of chronic slack in the economy--the growing gap between what we <u>can</u> produce and what we <u>do</u> produce. This is graphically illustrated in Charts 4 and 5. Especially since 1955, the gap has shown a distressing upward trend. As these charts make clear, the movement of the gap is roughly parallel to the unemployment ratio both within cycles and between cycles. However, the numerical level of the unemployment ratio greatly understates both the amount and the human cost of wasted economic potential.

The Gap between Actual and Potential Output. One symptom of increasing noncyclical slack is that successive upswings are shorter and weaker, as shown by several measures in Table 2. It is striking, for example, that unemployment was below 5 percent of the labor force in only one month at the top of the most recent cycle, but was below 3 percent in 11 months of the 1953 prosperity.

Table 2. Measures of Cyclical Expansion and Prosperity

Date of cyclical peak	Duration of previous upswing	Unemployment rate: Rate at cyclical peak	Unemployment rate: Number of months around cyclical peak with rate below 5 percent	4 percent	3 percent	Industrial production: annual growth rate from previous cyclical peak
	Months	Percent	Months			Percent
1953: July..	1/45	2.7	42	35	11	1/7.1
1957: July..	35	4.2	34	3	0	2.0
1960: May...	25	5.1	1	0	0	2.8

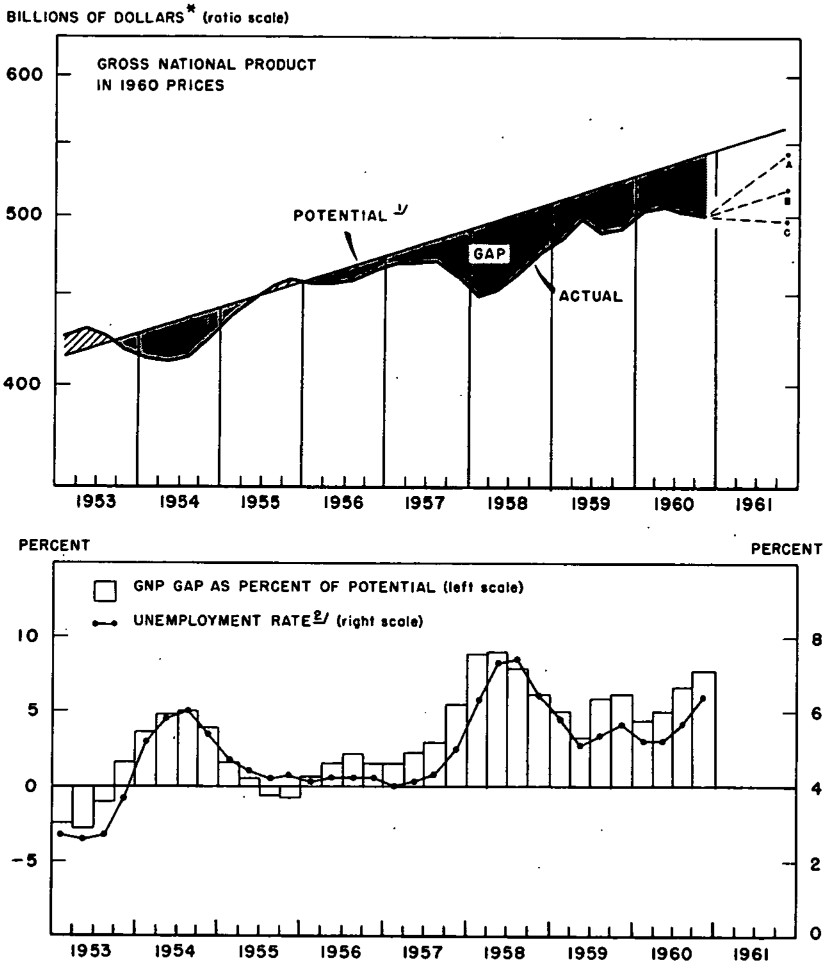
1/ Previous cyclical peak was November 1948.

Source: Council of Economic Advisers (based on Department of Labor and Federal Reserve data).

In the first year of the 1958-60 expansion, real GNP rose by 10 percent, but from the second quarter of 1959 to the second quarter of 1960

Chart 4

Gross National Product, Actual and Potential, and Unemployment Rate



* SEASONALLY ADJUSTED ANNUAL RATES.

1/ 3½ % TREND LINE THROUGH MIDDLE OF 1955.

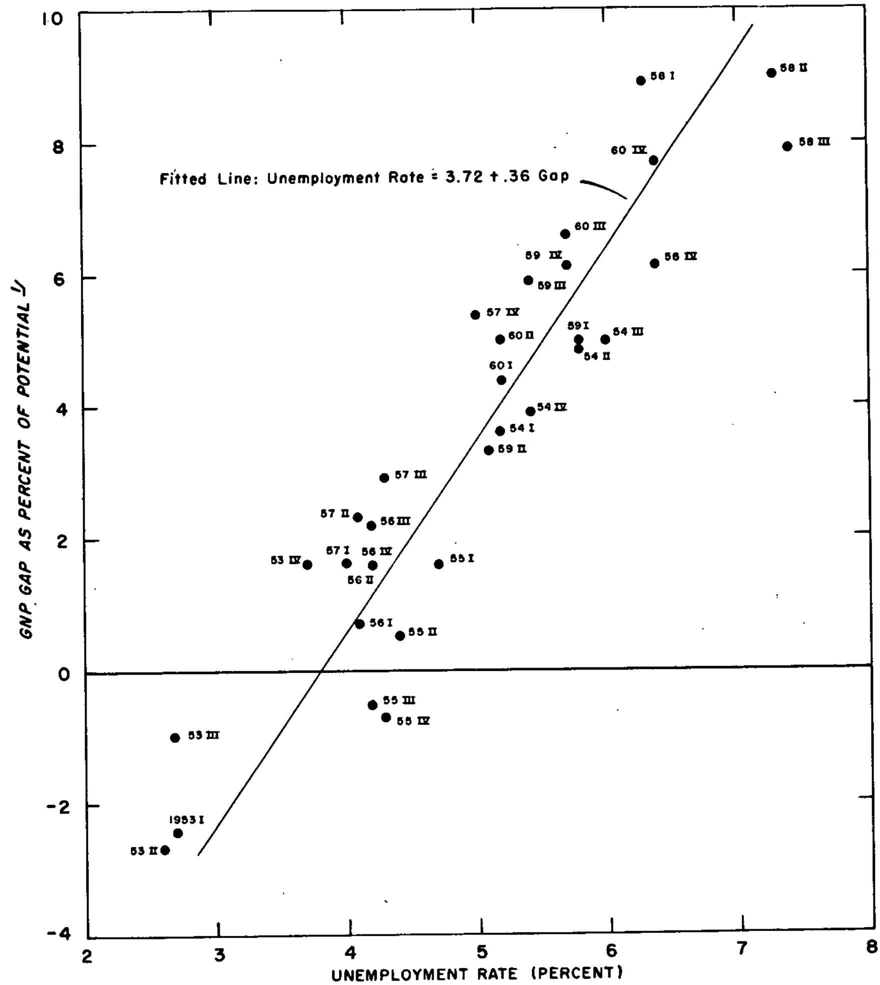
2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE; SEASONALLY ADJUSTED.

NOTE: A, B, AND C REPRESENT GNP IN 1961 IV ASSUMING UNEMPLOYMENT RATE OF 5%, 6½%, AND 8%, RESPECTIVELY.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

Chart 5

Relationship Between Unused Potential Gross National Product and Unemployment Rate



1/ GNP GAP (POTENTIAL GNP LESS ACTUAL GNP) AS PERCENT OF POTENTIAL GNP (ALL IN CONSTANT PRICES). POTENTIAL GNP IS 3½% TREND LINE THROUGH MIDDLE OF 1955.

2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE.

NOTE: ALL COMPUTATIONS ARE BASED ON SEASONALLY ADJUSTED DATA.

SOURCE: COUNCIL OF ECONOMIC ADVISERS (BASED ON DEPARTMENT OF COMMERCE AND DEPARTMENT OF LABOR DATA).

the rise was disappointing, amounting to only 2 percent. As a result of this incomplete recovery, the actual output of the American economy fell considerably short of its potential output even before the decline began last spring. A year ago, the 1960 Joint Economic Report stated, "An expected $510 billion gross national product for 1960 would be $20 billion to $30 billion below the economy's potential output, based upon a 4 percent rate of unemployment." In fact, 1960 GNP was $503 billion, or $7 billion short of expectations. The gap between actual and potential output for 1960 as a whole can thus be estimated at $30-35 billion, or 6 to 7 percent of total output.

This unused potential is equal to $500 per American household. It is two-thirds the amount we spend on national defense. It is almost twice the amount spent on public education. It is about one and a half times the amount spent on new homes last year. Even the world's most prosperous nation cannot afford to waste resources on this scale.

The problem of unused potential becomes continually more urgent. As the President stated in his economic message to the Congress on February 2, the potential of the American economy currently grows at about 3.5 percent a year. This growth in our economic capacity is made up of a rise in the labor force that follows a 1.5 percent per year upward trend and a secular increase in real gross national product per man averaging 2 percent per year. It is this 3.5 percent trend which is taken as the measure of growth of potential in Charts 4 and 5. (See Supplement A for a discussion of the data and technical analysis underlying these figures.)

The 3.5 percent rate is an estimate of the economic growth available to the nation in the absence of either new forces in the private economy or new governmental policies designed to accelerate the expansion of national productive capacity. In other words, it represents the rate of advance of gross national product (corrected for price changes) that our economy now achieves when it operates at reasonably full employment. But, as the President made clear in his message, the 3.5 percent growth rate is not high enough. It can and should be increased.

The level of the 3.5 percent trend of potential in Chart 4, from which the gap estimates of Charts 4 and 5 are derived, is fixed by a conservative estimate of the current capacity of the economy. An unemployment rate of 4.0 percent is taken as a reasonable target for full utilization of resources consistent with reasonable price stability. This target was achieved and surpassed during 1951-53 and was approached in late 1955 and early 1956. It is an attainable objective. If the target has seemed out of range in recent years, the fault lies in our poorer marksmanship.

We estimate that, if the seasonally adjusted unemployment ratio had been 4.0 percent rather than 6.4 percent in the last quarter of 1960, output would have been about 8 percent higher. Instead of just over $500 billion, output would have been $540 billion. This estimate is confirmed by several different methods of calculation.

First, a statistical relationship between real GNP and unemployment, based on quarterly data from 1947 to 1960, indicates that a fall of 2.4 percentage points in the unemployment ratio--from 6.4 to 4.0 percent--would yield an estimated rise in real GNP of about 8 percent. (See Supplement A.)

Second, according to calculations of potential output by James W. Knowles of the staff of the Joint Economic Committee in <u>The Potential Economic Growth in the United States</u>, the gap exceeded 8 percent by the end of 1960.

Third, the figure of 8 percent as the fourth-quarter 1960 gap is also arrived at by projecting the 3.5 percent trend from a base of actual economic performance in mid-1955. The year 1955 was one of prosperity and stable prices. The unemployment rate was slightly above 4.0 percent at midyear.

The underlying sources of the potential 8 percent expansion of output are spelled out in Table 3. The table reflects previous economic experience, which has demonstrated that a rise in output to its potential is accompanied not only by a decline in unemployment but by (a) an increase in the civilian labor force; (b) a rise in the average workweek; and (c) a marked increase in output per man-hour.

Table 3. Sources of Estimated Potential 8 Percent Increase of Gross National Product, Fourth Quarter 1960

(Percent)

Source	Associated increase of output
1. Reduction of unemployment to 4 percent..	2.6
2. Increase of labor force in response to greater demand........................	.8
3. Increase of hours of work per man associated with higher utilization.....	1.1
4. Increase of productivity per manhour associated with higher utilization.....	3.3
5. Interactions of the above effects.......	.2
Total........................	8.0

Note.--Detailed calculations underlying this table are shown in Supplement A.

Source: Council of Economic Advisers.

The size of the gap for the last quarter of 1960 illustrates a general point that is not widely enough appreciated in interpretation of the unemployment index. Unemployment runs parallel with the gap, as

Charts 4 and 5 clearly show. But the rise in percentage unemployment rates greatly understates the waste of economic potential. The data analyzed in Supplement A shows that when the unemployment rate rises by 1 percentage point above the 4 percent level, the gap between actual and potential production typically widens by a little more than 3 percentage points. At an unemployment rate of 7 percent (seasonally adjusted), the production gap would normally be between 9 and 10 percent.

Our current gap, as noted earlier, is not far from these levels today. This gap of about $50 billion (1960 prices) defines the urgency of the economic problem facing the nation today and in the months ahead.

Composition of Unemployment. Some have attributed the growth of unemployment in recent years to changing characteristics of the labor force rather than to deficiencies in total demand. According to this view, the new unemployment is concentrated among workers who are intrinsically unemployable by reason of sex, age, location, occupation, or skill. Expansion of overall demand, it is argued, will not meet this problem; it can only be met by educating, retraining, and relocating unsuccessful job-seekers.

The facts (which are examined in Supplement B) clearly refute this explanation of the rise of unemployment over the last 8 years. Only an insignificant fraction of this rise can be traced to the shift in

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composition of the labor force. The growth of unemployment has been a pervasive one, hitting all segments of the labor force.

In a free economy as large as ours, a certain amount of frictional unemployment caused by changes in the structure of industry and manpower is unavoidable. In addition, a small fraction of the adult population is unemployable. Yet, there is no evidence that hard-core unemployment has been growing as a percent of the labor force. Measures to improve the mobility of labor to jobs and of jobs to labor, to better our educational facilities, to match future supplies of different skills and occupations to the probable pattern of future demand, and to improve the health of the population--these are and should be high on the agenda of national policy. But they are no substitute for fiscal, monetary, and credit policies for economic recovery. Adjustments that now seem difficult, and unemployment pockets that now seem intractable, will turn out to be manageable after all in an environment of full prosperity.

The Promise of Full Recovery. Restoring the economy to capacity operations, apart from abating the misery and human waste of unemployment, would make impressive contributions to our national economic objectives: (a) to the fiscal capacity of government at all levels; (b) to the flow of capital investment so urgently needed to maintain economic growth and improve the competitive position of American industry; and (c) to the welfare of all segments of our population.

Government revenues, particularly those of the Federal Government, are highly sensitive to economic activity. Chart 6 is illustrative of the dependence of Federal budget receipts on gross national product. Were the economy to operate at full employment levels in 1961, and at comparable rates in the first 6 months of 1962, it is estimated that Federal revenues in fiscal 1962 would be $92 billion. This would exceed the expenditures estimated in the Budget Message of January 16, 1961, by $11 billion and the revenues by $9-1/2 billion. Moreover, if the economy grows at 3-1/2 percent per year, the present Federal tax structure will increase budget receipts by $3 to $3-1/2 billion per year. The revenues of a fully operating economy would finance the Federal programs needed to accelerate the growth of productive capacity and meet national priorities at home and abroad, while leaving room for substantial retirements of Federal debt from budget surplus.

Economic recovery will also improve the financial position of hard-pressed State and local governments. The growth of population and of needs for facilities and services provided by these governments is straining their financial resources. During the last quarter of 1960, these governments were spending at a rate $4.2 billion above their receipts (on an accrual basis). With full recovery, their receipts would approximately cover their present outlays.

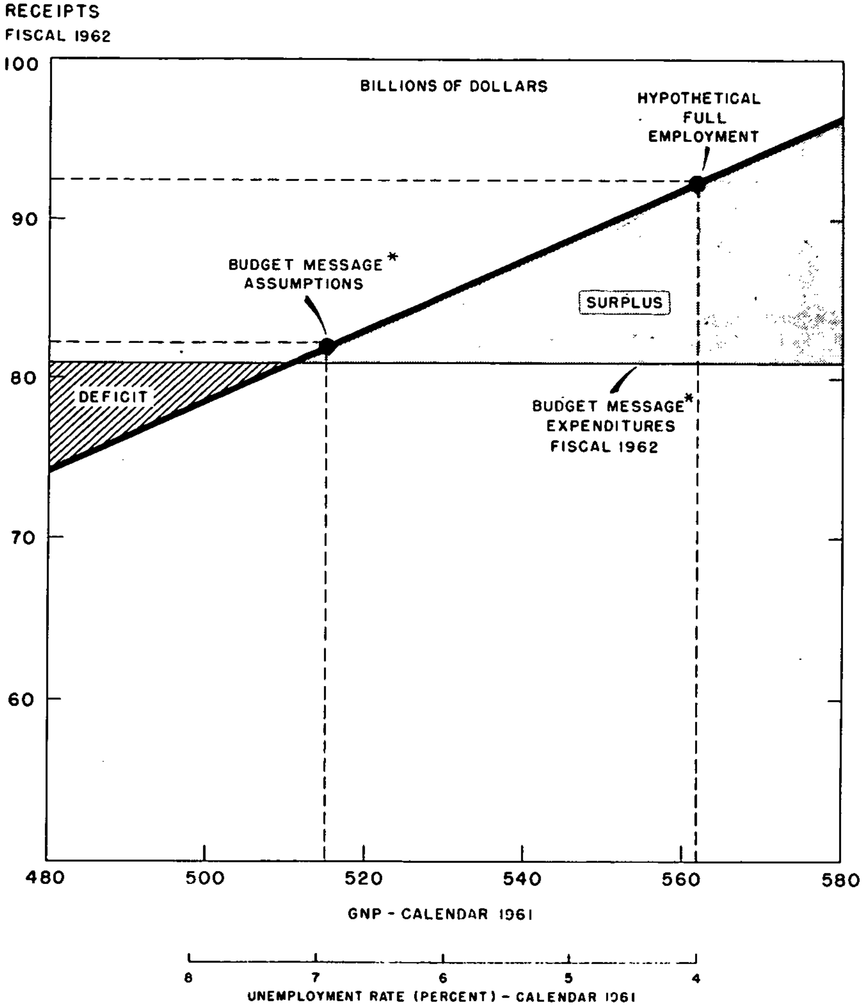
In 1960, business expenditures for new plant and equipment, corrected for price changes, were 9 percent below the levels achieved in 1956 and 1957. Investment in new productive facilities has been falling absolutely. It has fallen even more sharply in relation to actual GNP, let alone, to potential GNP. To increase the attainable rate of growth of the economy, we must increase the share of our current potential output that we devote to new investment. Full recovery can make two contributions to this objective. The first is to add the pressure of vigorous consumer demand and resulting profits to the incentives for expansion and modernization of productive facilities. The second is to provide additional saving to finance investment--direct personal saving, retained business earnings, and government surplus. Corporate profits were about $44 billion in 1960. In a fully operating economy in 1961 corporate profits would be about $58 billion, providing enhanced incentive to undertake investment and greater resources to finance it, as well as more revenue for the Federal Treasury.

Table 4 shows personal income and consumption in 1960, in comparison with the levels which would be generated by hypothetical full employment in 1961. Disposable income and consumption per capita--in constant prices--could be 5 percent higher. This increase in resources available for private households would permit an intensified attack on poverty, hunger, ill health, and financial insecurity, while allowing for gains in well-being by all segments of the population.

Chart 6

Dependence of Federal Budget Receipts on Gross National Product

(Illustrative Estimate)



* BASED ON JANUARY 1961 BUDGET MESSAGE.

SOURCE: COUNCIL OF ECONOMIC ADVISERS.

Table 4. Selected Components of National Output and Income

Output component	1960 actual		1961 potential (estimated)	
	Amount (1960 prices)	Percent of GNP	Amount (1960 prices)	Percent of GNP
	Billions of dollars		Billions of dollars	
Gross national product	503.2	100.0	554	100.0
Disposable personal income	354.2	70.4	378	68.2
Personal consumption expenditures	327.8	65.1	350	63.2
Corporate profits before taxes	44	8.7	58	10.5
Government net receipts on income and product account 1/	99.9	19.9	117	21.1
Federal	55.5		68	
State and local	44.4		49	
	Dollars		Dollars	
Per capita:				
Disposable personal income	1,969		2,068	
Personal consumption expenditures	1,822		1,915	

1/ Receipts less transfer payments, interest, and subsidies. Grants-in-aid are deducted from Federal receipts and included in State and local receipts.

Sources: Department of Commerce and Council of Economic Advisers.

While full recovery would significantly increase total consumption, it would--as Table 4 shows--diminish the ratio of consumption to gross national product. The great sensitivity of government revenues and corporate profits to cyclical increases of GNP has been noted. As the economy approaches full employment, this sensitivity increases the share of national output available for private investment and government purchase--in relative proportions that depend on how increased government revenues are divided between expanded programs and budget surplus. This change in the composition of national expenditure is one of the several ways in which full recovery can contribute to acceleration of growth, at the same time that it provides a generous increase in total and per capita consumption.

The Problem of Accelerating Growth

As indicated above, the underlying changes in the supply of labor and productivity per man would have permitted real output to grow at roughly 3.5 percent a year since 1955. This potential has not vanished; it is still there. The questions we consider in this section are, first, whether it will continue to grow unchecked if we do not close the production gap; and, second, whether deliberate policy can increase the long-run growth of output.

Between the first quarter of 1947 and the fourth quarter of 1953, GNP grew from $316.5 billion to $419.6 billion (annual rates, 1960 prices), or nearly 4.5 percent per year. Calculations similar to those in Supplement A confirm that this is a reasonable approximation to the rate of growth of potential during the early postwar years. Of course, the fact that 4.5 percent growth of real output occurred then--and at occasional earlier periods in our history--is by itself no guarantee that 4 percent growth or better would be sustainable now. To some extent the years after 1948 were still affected by the aftermath of the war. To judge how much faster than 3.5 percent a year the economy could grow now, we must consider the sources of increase in potential output.

Between 1947 and 1953, the total labor force grew at approximately 1.5 percent per year. This is roughly the same rate that we estimate for the years just past and just ahead. The difference between the 4.5 percent potential growth rate then and the 3.5 percent now is accounted for by a more rapid increase of productivity per man.

The twin keys to an accelerated growth of productivity and output are two forms of investment: investment in education, health, natural resources, research and development for technical advance; and investment in the expansion and modernization of the Nation's stock of business plant and equipment. Capital expansion is especially hobbled and slowed by the continued presence of slack and unused capacity. One of the reasons for the recent slowdown in the rate of growth of productivity and output is a corresponding slowdown in the rate at which the stock of capital has been renewed and modernized. And even the less material kinds of investment--in research and in human resources--may be expected to respond to a quickening of the economic pulse.

Some of the elementary facts showing that there has been a slowdown in the renewal and expansion of our capital stock are as follows:

1. Investment in fixed capital (producers' durable equipment plus "other construction") stood at 12.5 percent of GNP in 1948. This ratio has declined more or less steadily since then (with a partial recovery to 11 percent in 1956), until in the last three years it has fallen below 10 percent and stood at 9.1 percent in 1959 and 9.6 percent in 1960. The relative fall in the "producers durable equipment" component has been even more dramatic, falling from 8.3 percent of GNP in 1948 to 5.6 percent in 1959-60. The sharper fall in the equipment rate is significant because equipment, more than plant, is par excellence the carrier of new processes, new commodities and technological progress.

2. In 1945 the average age of the stock of equipment was 10.6 years, and the average age of plant was 27.2 years. As a consequence of the high rates of investment in the immediate postwar years, the average age of equipment declined step by step to a minimum of 8.5 years in the period 1952-1955. Since then the average age of equipment has begun to creep upward again, reaching 9.0 years in 1959, the same as in 1948. Since 1945 the average age of the stock of plant has declined slightly--but steadily--to 24.2 years in 1959.

3. The fraction of the stock of business equipment which is 5 years old or less has been declining from a high of 50 percent in 1950, to something like 37 percent in 1959. Other estimates show that the annual rate of increase of the gross stock of privately-owned producers' durables fell from 8.2 percent in 1947 and 9.6 percent in 1948 to 3.9 percent in 1957 and 2.9 percent in 1958.

In brief, since 1955-1957 the increase in stock of plant and especially equipment per worker has been slowed. In the same period, the age distribution of the country's capital equipment has been shifting somewhat unfavorably. It seems likely that these developments are responsible for the observed slowdown in the rate of economic growth and, particularly, in the rate at which productivity per man-hour increased.

In recent years, economists have assigned a much larger role to improvements in human resources and increases in knowledge as a source of growth relative to increases in physical capital. This shift in emphasis and its implied consequences for policy toward education, training and research are overdue. Yet, as has been confirmed by more recent research, the great importance of capital investment lies in its interaction with improved skills and technological progress. New ideas lie fallow without the modern equipment to give them life. From this point of view the function of capital formation is as much in modernizing the equipment of the industrial worker as in simply adding to it. The relation runs both ways: investment gives effect to technical progress and technical progress stimulates and justifies investment.

A second causal factor tending to slow down the rate of growth since 1955 is the failure of market demand to expand adequately. This factor in part operates independently and in part underlies the retardation in investment. In the long run, productive potential will not grow faster than the demand for output for consumption and investment purposes, for public expenditures and for export. The best stimulus to capital expansion is pressure on present capacity, and that has been noticeably lacking in most industries since the mid-fifties.

In summary: The long-run rate of growth of the labor force has been about 1.5 percent per year. There have been periods of slower growth owing to declines in the birth rate, as in the 30's, and to slack in the demand for labor. Demographic factors indicate that for the near future we can count on a return to the historical 1.5 percent increase. Normal growth of productivity per man at the recent rate of 2 percent per year will permit a return to a growth line rising at 3.5 percent a year from the peak of 1957. As the gap between current and potential product narrows, as firmer markets for commodities and special programs create a more favorable climate for business investment, new possibilities for improvements in productivity will emerge. The cultivation of the country's human and natural resources, and the devotion of a larger fraction of current output to the modernization and expansion of the stock of capital will accelerate the process of improving skills and technology.

The question will then arise: is the "normal" growth rate enough? This question should be considered even before the Nation achieves full recovery. Among the alternative measures for meeting the short-term and intermediate goals of reversing the recession and achieving full recovery, some will strongly stimulate long-run growth more than others.

First, it is necessary to grasp the magnitudes involved. Starting from a 1960 potential GNP of $535 billion and assuming constant prices, growth at 3.5, 4, and 5 percent per year would lead to aggregate output levels of $755 billion, $792 billion, and $871 billion respectively in 1970. Even an increase from 3.5 to 4 percent in the rate of growth of potential output means an extra $38 billion of goods and services available for use in 1970. Population will have been increasing at about 1.5 percent so that a 4 percent growth in gross national product will mean an increase in output per person of 2.5 percent per year.

If we adopt policies to improve our human and natural resources and return to the rate of capital expansion and renewal experienced in the late 40's and early 50's, the Nation could achieve impressive gains of output in the present decade. Few Americans would wish to miss this opportunity. Despite the enviably high average standard of living the country already enjoys, the age of abundance is not yet with us, nor will it be with us in 1970. Averages conceal pockets of poverty and missed opportunity especially among the aged, the uneducated, nonwhites, and families broken by disease, death or divorce. An equitably distributed increase of private consumption has a strong claim on the extra output available from stepped-up growth.

There are also vital public uses for output. On the domestic scene, the President has pointed to the urgent needs for expanded resource use in education (for leisure as well as work), in health and medical research, in the renewal and beautification of our cities, in highways, water supply and the control of pollution, and in conservation. We can never be sure that requirements for the military security of the Nation and the free world will not increase in the future.

Finally, America's international obligations, especially economic aid to the underdeveloped countries of the world, offer an important opportunity which it will be easier to grasp if domestic output grows rapidly. It is to be expected and welcomed that living standards the world over will become more rather than less equal over the decades. But this is not to say that the fruits of economic growth of the advanced countries have a low order of priority. In this connection, a demonstration of the ability of a free economy to achieve high rates of growth is of incalculable value.

For all these reasons, opportunities to accelerate economic growth are important. Programs to reverse the recession and attain recovery should be followed and accompanied by policies designed to raise our growth in potential above the 3.5 percent rate which has become "normal" in the slack years since 1955. Short-run policies should, as far as possible, also serve long-run ends. Fortunately, the objectives are consistent and mutually reinforcing.

The Balance of Payments

During 1960 the United States ran a $3.8 billion balance-of-payments deficit. This was almost as large as in 1959, the previous high. The 1960 gold loss totaled $1.7 billion; the increase in our short-term liabilities to foreigners, $2.0 billion.

The 1960 payments deficit and the accompanying gold drain were greatly enlarged by short-term capital movements from the United States--money which moved abroad in search of high interest rates and in response to unfounded rumors that we would devalue the dollar. The total short-term outflow may have amounted to more than $2 billion.

Speculation against the dollar came to an end early this year, largely because of the President's firm commitment to defend the dollar. The outflows of short-term funds induced by interest-rate differences also seem to have tapered off, but capital flight due to speculation could resume if we were to go on running a deficit in our other transactions with the rest of the world. We now have a needed respite--time in which to reduce this deficit and to strengthen international financial arrangements.

"Deficit" in the remainder of this discussion of our international position refers to the difference between U. S. outlays for goods, services, long-term securities, and industrial assets, and the corresponding U. S. receipts. This deficit concept excludes short-term capital movements and unrecorded transactions and is consequently more appropriate in appraising our fundamental international economic position. It is estimated that this deficit totaled $1.6 billion for 1960. This is a considerable improvement over 1958 or 1959, but it would be imprudent to extrapolate this favorable trend.

While our exports increased sharply in 1960 we cannot reasonably expect a further increase this year. We must expect declines in some exports, such as cotton, which were unusually high in 1960. Further increases in exports can be foreseen because of recent reductions in discrimination against dollar goods. Moreover, if the European boom continues, and if recovery here raises the foreign exchange earnings of traditionally favorable markets in Canada and Latin America, we can expect a substantial improvement in our exports to those areas over the unusually low levels of the past two years. Altogether, we will do well to maintain our over-all 1961 export total at last year's level. On the other hand, we must anticipate some increase in our imports, as recovery gets under way in the United States. This could mean a decrease in our trade surplus. On the favorable side, we may see other changes—a decline in U. S. long-term private investment in other industrialized countries as our own business prospects improve, an increase in our earnings on past foreign investment, and the measures taken by the Government to economize on its overseas spending. These favorable changes will tend to offset any worsening in our trade balance.

Full recovery might increase the import bill by $1.5 to $2.0 billion over its 1960 level, as it would enlarge our demand for raw materials and finished goods. We could expect some offsetting benefits, as investment in the United States becomes relatively more attractive because of improved American profit opportunities. And a rise in imports from the raw materials producing countries will provide them the funds to import from this country. In the process of attaining full employment, we might enjoy a large reflux of short-term capital.

The increase in the United States deficit in recent years has produced widespread concern that we may have "priced ourselves out of world markets." The statistical evidence is not conclusive. Some measures of price change during the 1950's showed greater increases in Europe than in the United States, while others showed the opposite. Wage costs per unit of output have risen faster here than in Italy, Japan, or France, but no faster than in Germany, or Canada, and more slowly than in Britain, the Netherlands, or Sweden.

The prices of some key American export goods, notably steel and steel-intensive products, seem to have risen more rapidly than export prices abroad, and these price movements have damaged our trade balance. But some of our difficulties are not the result of any sudden deterioration in our position. They may be better explained as a consequence of foreign competitive advantages long latent but only recently exploited. Many American products have long been vulnerable to a competitive challenge here and in foreign markets. By the middle 1950's Europe and Japan, having finished repairing the damage done by World War II, began to seize opportunities here and in other markets.

Compounding our payments problem, some American manufacturers have been slow to respond to the challenge of foreign competition and to redesign their products to meet changing needs and tastes here and abroad. The final response of these industries has usually been powerful enough, but too slow to prevent doubts about the competitiveness of American industry. Other American products, notably coal and oil, have been afflicted by global shifts in supply and demand and by trade policies abroad.

New direct foreign investments of American firms (including profits reinvested) have run near $3 billion a year for several years. American firms have been going abroad to save on labor and transport costs, to claim sizable tax benefits, to participate more fully in the rapid growth of other industrial countries and, most recently, to vault over Europe's new common tariff. The expansion of U. S. production in other countries has probably pre-empted a part of our export market and swelled our import bill. It has also shortened our technological lead, because our skill and product design go abroad with our capital.

While pursuing vigorously our policies for domestic recovery, we must seek also to strengthen our international position. We must encourage business investment designed to reduce costs and to improve products as well as to expand capacity. We must advance the skill and efficiency of our workers. But efforts to increase productivity will be of little help to our balance of payments if wage and price advances gobble up the gains.

The United States still enjoys great competitive power and financial strength. Our exports far exceed our imports. Our gold reserves are still very large, nearly as large as our obligations as an international banker. Few banks or banking nations have ever been as liquid. There is growing realization abroad that the U. S. payments position is a world problem and that other governments have an obligation to cooperate in corrective policies and to defend and strengthen the international monetary system.

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III. ECONOMIC POLICY

In this section, we shall discuss major governmental policies to reverse the recession, achieve full recovery, and promote growth. By focusing on governmental policies, we do not intend to suggest that recovery and growth depend exclusively--or even primarily--on the government. The prosperity and progress of a free society depend principally on the enterprise and skill of private citizens. The government seeks to strengthen the forces of recovery and growth in the private economy.

Monetary Policy and Debt Management

In this recession, for the first time since 1931-32, expansionary monetary policy has been limited by the international financial position of the United States. Over the past six months our balance of payments deficit has been severely aggravated by the outflow of short-term capital attracted by higher short-term interest rates abroad. To stem the outflow, Federal Reserve authorities have had to limit expansion of money and credit, especially in recent months, to keep short-term interest rates from falling too far. Short-term rates have remained 1.5 to 2 percentage points above past recession levels. The Federal Reserve discount rate, which fell as low as 1.75 percent in the 1958 recession, is 3 percent today. The Treasury bill rate reached 0.6 percent in May 1958 but stands at 2.6 percent today, up from its recent low of 2.1 percent in November 1960.

The Federal Reserve has sought since October to expand bank reserves in ways that do not directly lower bill rates and other rates important in holding internationally mobile liquid funds. These efforts have met with some success. The money supply (defined conventionally as demand deposits and currency) has risen 1.4 percent since June 1960, and the money supply (defined to include also time deposits) has risen about 4 percent. However, interest rates have remained relatively high throughout all segments of the money and capital markets. Whether interest rates are regarded as a cause or as a symptom of borrowing and lending activity, substantial monetary and credit expansion can scarcely occur without significant easing of rates.

The "prime rate"--the rate New York banks charge their prime-risk customers for commercial loans--is 4.5 percent now, in comparison with 3.5 percent in 1958 and 3 percent in 1954. Corporate Aaa bonds yield 4.2 percent now, in comparison with 3.6 percent and 2.8 percent in the two preceding cyclical troughs. Table 5 compares interest rate levels today with those in previous recessions, and shows in the same comparative perspective how little long-term interest rates have fallen so far in this recession.

The Federal Reserve has recently announced that it is purchasing long-term U. S. Government securities on the open market. The new policy is an extension of its efforts to provide additional reserves by purchases that do not directly depress the short-term rate. The objective is to lower long-term interest rates, in order to increase business investment and residential construction, while maintaining the discount rate and related short-term rates at internationally competitive levels. Treasury public debt operations are also geared

Table 5. Interest Rates and Bond and Mortgage Yields

(Percent per annum)

Date	U. S. Government securities: 3-month Treasury bills 1/		U. S. Government securities: U. S. Government long-term bonds 1/		Corporate Aaa bonds (Moody's) 1/		State and local Government Aaa bonds (Moody's) 2/		FHA home mortgages	
	Rate	Period	Rate	Period	Rate	Period	Rate	Period	Rate	Period
1953-54:										
High...	2.416	6/6/53	3.19	6/6/53	3.42	6/20/53	2.73	6/25/53	4.87	9/53
Low....	.616	6/12/54	2.45	8/7/54	2.85	3/20/54	1.90	9/2/54	4.56	12/54
1957-58:										
High...	3.660	10/19/57	3.76	10/18/57	4.14	9/28/57	3.45	8/31/57	5.63	9/57
Low....	.635	5/31/58	3.07	4/26/58	3.55	5/3/58	2.64	4/26/58	5.35	7/58
1959-61:										
High...	4.670	12/26/59	4.42	1/9/60	4.61	12/31/59	3.65	9/26/59	6.24	1/60
Low....	2.127	11/5/60	3.75	8/6/60	4.23	8/27/60	2.99	8/27/60	6.00	1/61

1/ Weekly averages of daily figures.
2/ Thursday figures.

Sources: Board of Governors of the Federal Reserve System, Treasury Department, Moody's Investors Service, and Federal Housing Administration.

to this objective. Federal Reserve and Treasury operations may be expected to result in reduction of the stock of long-term bonds available to private investors, relative to the outstanding supplies of short securities. The extent to which the maturity structure of rates can be "twisted" by these operations remains to be seen. But the experiment must be tried. The domestic economy urgently needs the stimulus of lower effective long-term and commercial rates. At the same time, as confidence in the dollar is restored and as interest rates abroad continue to fall, the constraint on our short-term rate can safely be relaxed.

The economy needs the stimulus of low interest rates and greater credit availability, not merely for recovery of the ground lost in the recession but for the more difficult and important tasks of restoring full employment and promoting growth. As shown in Chart 6 and Table 4, the present Federal revenue system would produce a substantial surplus over current budget expenditure levels at full employment. The corresponding revenues would provide an excellent opportunity to promote economic growth both through government programs and through private investment. But the "latent surplus" may also make the attainment of full recovery more difficult. Full recovery requires that investment by business, and by State and local governments, be expanded significantly and must be maintained at high and increasing levels. Although some of the stimulus for investment can be provided by tax incentives, it is important to maintain monetary and credit conditions that are favorable to the necessary flow of funds. Monetary policy must at all times be flexible and interest rates must be higher in booms than in recessions. But the larger the share of the task of preventing inflationary excesses of demand that is assigned to fiscal policy, the smaller the burden that will fall on restrictive monetary policy.

The Western world has recently entered a new era of convertible currencies, in which short-term funds can move in large volume and at great speed from one country to another. Losses--or gains--of funds can restrict a country's freedom of action in domestic policy to an undesirable degree. The recent experience of the United States is an example; similar outflows may embarrass us again, or strike countries less well insulated by international reserves. The President noted in his message of February 6 two measures by which the United States could, if necessary, seek to hold foreign official dollar balances while lowering domestic short-term interest rates. The first, which requires Congressional approval, is to permit U. S. commercial banks to compete for official foreign time deposits by offering rates above the general ceiling set by the Federal Reserve. The second, which is already within the power of the Secretary of the Treasury, is to offer special securities for foreign central banks and governments. In the long run, however, reconciling the requirements of domestic economic stability with those of international currency convertibility will require multilateral understanding and accommodation. In this connection, the President said in his balance of payments message, "I have requested the Secretaries of State and Treasury to work for still closer cooperation between the monetary and financial authorities of the industrialized free nations with a view toward avoiding excessive short-term money flows which could be upsetting to the orderly development of international trade and payments."

Housing Credit

Credit policy affects many families directly through its impact on the mortgage market.

Private housing starts have been declining for nearly two years. Inventories of unsold new houses are significantly higher than in early 1959. In the three previous postwar recessions, revived strength in housing activity operated to sustain the economy; in the current recession, this has not been the case.

The present weakness in housing construction is in part a legacy of the high level of building activity in 1958-59. It is also, in part, a consequence of demographic factors; because of low birth rates in the 1930's, the number of persons reaching the average age of first marriage in the last few years has been temporarily low. Private housing starts reached an annual rate, seasonally adjusted, of 1.6 million in April 1959, then declined to 980,000 in December 1960. A recovery to 1.1 million occurred in January 1961.

This is not, however, the whole story. Residential construction has been further depressed by high interest rates on mortgages. It is difficult to accept the view that the housing market is so glutted that it would not respond to lower monthly financing costs. The possibilities for such reduction through lower interest rates are substantial, for example, a reduction of 1 percent in the rate of interest on a 30-year mortgage could reduce monthly mortgage payments by more than 10 percent.

Mortgage interest rates are sticky prices. Though availability of mortgage funds improved in 1960, interest rates responded only sluggishly. The average decline was less than 1/4 of 1 percent. In the face of a depressed level of home building activity, rising liquidity in many lending institutions, and a continuing decline in long-term interest rates generally, the cost of housing credit should have fallen more sharply. Mortgage interest rates of 6 to 7 percent are out of touch with the realities of 1961.

The Administration has taken a number of steps to hasten the decline in mortgage lending rates. The maximum permissible interest rate on FHA-insured loans has been reduced. The FNMA, in its secondary market operations, has increased both its selling prices and its buying prices for mortgages. At current FNMA selling prices, most lenders will find it more attractive to seek other investments than to buy existing mortgages from FNMA. The search for other investments will help, directly or indirectly, to push down interest rates on new mortgages.

The Federal Home Loan Bank Board has assisted the Administration's effort to stimulate housing construction and lower the cost of housing credit by a number of revisions in its policies and regulations. Also, the President has requested the Chairman designate of the FHLBB to meet with leaders in the savings and loan field and to urge them to reduce mortgage rates.

Further measures to stimulate housing demand will become possible as general monetary conditions are further eased.

Fiscal Policy

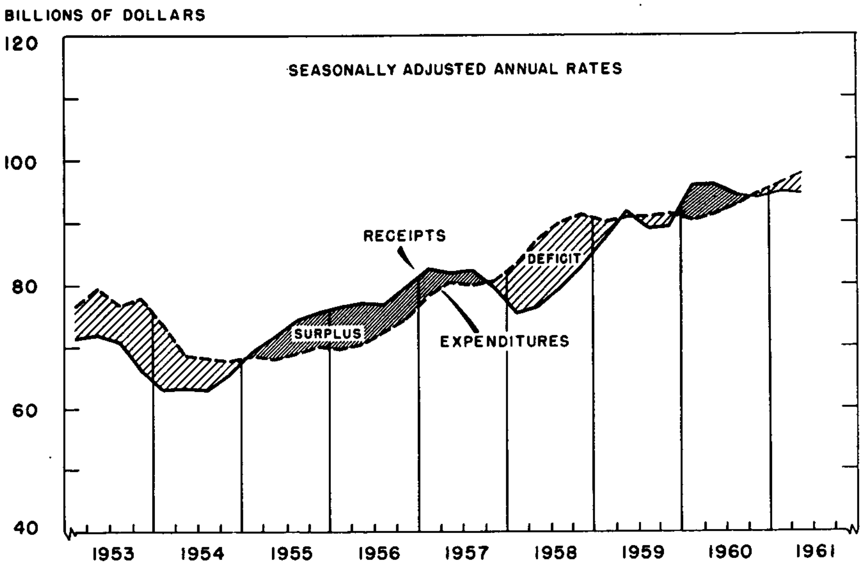
The Federal budget serves as an important stabilizing force in our economy. In part, this force is exerted through the rhythm of automatic changes in tax receipts and transfer payments as incomes rise and fall. In part, it is the result of conscious changes in tax and expenditure programs. For example, taxes were reduced several billion dollars in 1954 through scheduled expirations of certain taxes and new legislation; expenditures were increased several billion dollars in 1958 by expansion and acceleration of government programs. In recent years, revenues have risen and expenditures have fallen slightly as a percentage of gross national product. As a result, both the automatic cycle of the budget and the impact of legislative changes revolve around a higher ratio of revenues to expenditures than was formerly the case.

As demonstrated in Chart 7, the combination of automatic and discretionary budget forces has generated substantial surpluses in prosperity and deficits in recession. There is wide consensus that the surpluses have been helpful in restraining inflation, and the deficits in cushioning recession and promoting recovery. This is not to say that either the size or the timing of budget changes have been perfectly fitted to the movement of the business cycle. But by and large, the fiscal system has served as an important stabilizing influence.

Three important characteristics of the automatic responses of the budget should be noted, especially as they bear on the current recession

Chart 7

Federal Government Receipts and Expenditures
(National Income Accounts Basis)



SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

and the outlook for recovery. First, under present conditions and tax rates, the "built-in" flexibility of the Federal budget offsets between 25 and 30 percent of the drop (or increase) in GNP, with approximately one-half of the offset coming from corporate taxes, one-quarter from personal income taxes, and most of the rest from the various social security programs. As Chart 6 illustrates, Federal receipts alone decline $3.4 billion for every 1 percent increase in the rate of unemployment.

Second, welcome as the built-in stabilizers are when the economy contracts, they are a mixed blessing when it expands. As soon as business conditions take a turn for the better, we can expect the Federal tax system automatically to cut into the growth in private incomes. When the economy again reaches the boom phase, this drain on private incomes will serve as a desirable restraint on inflation. But up to that point, it tends to slow down the recovery process.

Third, because economic growth automatically broadens the tax base, the revenue-raising power of the Federal tax system has been rising relative to expenditures. Indeed, tax revenues--even at stable tax rates--rise more than proportionately to GNP. Table 6 drives home this point. At roughly comparable phases of business activity--8.9 percent below potential in the first quarter of 1958 and 7.7 percent below potential in the fourth quarter of 1960, and in both cases prior to the impact of active anti-recession measures--the deficits were vastly different. In the first quarter of 1958, the deficit was running at an $8 billion annual rate. Last quarter it was less than $1 billion. In other words, the relative growth of revenues in recent years brings the budget

Table 6. Comparison of Federal Receipts, Expenditures, and Deficit in Recessions of 1958 and 1960

(Income and Product Accounts)

Item	First quarter 1958		Fourth quarter 1960		Calendar 1958		Calendar 1960	
	Billions of dollars 1/	Percent of GNP	Billions of dollars 1/	Percent of GNP	Billions of dollars	Percent of GNP	Billions of dollars	Percent of GNP
Federal receipts..	75.4	17.5	94.0	18.7	78.6	17.7	95.3	18.9
Federal expenditures............	83.5	19.3	94.6	18.8	87.9	19.8	92.3	18.3
Surplus (+) or deficit (-)......	-8.1		-.6		-9.3		3.0	
Gross national product..........	432.0		503.5		444.2		503.2	
Gap as percent of								
Potential GNP 2/		8.9		7.7		8.0		6.0
Actual GNP 2/..		9.8		8.3		8.7		6.3

1/ Seasonally adjusted annual rate.
2/ Based on GNP in constant prices.

Sources: Department of Commerce and Council of Economic Advisers.

into balance substantially below full employment at current levels of Federal expenditures and tax rates. In the absence of tax cuts, large expenditure increases, or a substantial worsening of the economic situation, only modest deficits are likely to develop.

Deficits as large as those experienced in the 1958 recession could materialize in the current recession only if unemployment and unused potential grew substantially larger than they were at the bottom of the 1958 recession, or if a very much greater expansion of government programs than now contemplated were undertaken. Indeed, recent fiscal trends make clear that full recovery with the present tax structure would generate substantially more revenue than is required by the President's proposed programs, thus leaving a generous margin for retirement of debt and restraint of inflation. Whether this margin is consistent with the achievement and maintenance of full employment cannot yet be determined.

In his "Program to Restore Momentum to the American Economy," President Kennedy announced executive action and recommended legislation to help reverse the decline and set the American economy on the road to recovery. Since that time, the President has also proposed programs in education, health, natural resources and highways, which, while fully justified on their own merits, promise additional benefit in the form of speedier recovery. The exact cost of all these programs, their timing, and their impact on the 1961 and 1962 Budget and on receipts from and payments to the public (the consolidated cash budget) are not yet known. A review will be undertaken by the Director of the Budget in his appearance before the Joint Economic Committee later this month.

However, the costs of the largest programs are already known. It may be useful to the Committee to appraise in general terms the economic impact of these programs as they relate to the problems of recession and recovery. For this purpose, we have estimated the over-all magnitude of the programs. However, this estimate does not refer to Budget expenditures, for two reasons.

First, it is an estimate of the impact of the programs in the income-and-product account. Unlike either the Budget or consolidated cash accounts, the income-and-product data are assimilated directly to the GNP accounts and are shown, to the extent possible, on a current (accrued) basis. These accounts diverge from the conventional and cash budget figures. Moreover, some of the President's recommendations, like the improvement in old age, survivors, and disability insurance, affect only the trust accounts and thus are reflected in the income-and-product account without any direct effect on the conventional Budget.

Second, the times of enactment of the various programs are uncertain. Some programs are likely to be enacted very quickly, e.g., temporary unemployment compensation, and will therefore still affect the fiscal 1961 budget, while others will not take effect until fiscal 1962. To simplify matters, we have put all the available calculations on the same basis by making the assumption--unrealistic but adequate to our present purpose--that all the recommended legislation is enacted at the same time.

This calculation shows that the President's program would generate an estimated flow of at least $3 billion to consumers and business during the first 12 months after enactment. This estimate includes only programs for which costs have already been made public: temporary unemployment compensation, aid to dependent children, OASDI changes, area redevelopment, aid to education, and several smaller programs. It omits such items as advanced procurement, speed-up in funded public works, and proposals that may be developed in the field of housing. Further, it does not include the impact of such additional defense expenditures as may prove to be necessary for national security.

Even if this estimate included all of the President's proposals, it would not measure the full stimulative effect of the Administration program. First, only the primary effects are measured, leaving out the further expansionary effects as funds are spent by the recipients. Second, acceleration of construction and contract letting may not be reflected in the Government's income accounts for a long time but may have immediate stimulative effects on the inventory, employment, and equipment needs of the contractors. Third, the nonbudgetary programs--notably, the move to reduce interest rates and increase credit availability--can have important stimulative effects.

The President said in his February 2 message, "If economic developments in the first quarter of this year indicate that additional measures are needed, I will promptly propose such measures." Any such measures will, of course, have substantial fiscal impacts. A further program for economic recovery might consider a speed-up in Government construction and related projects, an expansion of housing programs, and tax reduction.

If a new reading of the economic and fiscal situation indicates that additional measures are needed, a temporary income tax reduction offers one of the most important methods for further economic stimulus. It offers a method of stimulating the economy quickly and effectively, at the same time preserving the basic revenue-raising power of the tax system for later use in financing Government programs and stemming inflation. The beneficiaries of a personal income tax cut, especially in the lower brackets, would promptly spend a large part of the proceeds on goods and services, thereby stimulating production, employment, and income.

In appraisal of the usefulness of expanded Government expenditures in promoting recovery, the timing of their impact is often considered to be of decisive importance. This may be the case in a recovery which starts from a position not far below the economy's full potential. In such a recovery there is a danger that the impact of slow-starting Government projects comes too late to aid the recovery but instead aggravates an inflationary boom. The present situation is not of this kind. The decline began from a position of substantial unemployment and excess capacity. We face a stubborn problem of chronic slack, and the road to full recovery is a long one. The expansionary effects of Government programs will be welcome even if they occur well after the recession has been reversed.

In the spring and summer of 1958, the delayed impact of new expenditure programs may have appeared to be a real danger. Output was rebounding rapidly, and the outlook for housing was bright. As it turned out, fears of perverse timing were unnecessary, because the recovery was abortive. With that incomplete recovery behind us, the problem of chronic slack is more clearly evident today. Also, the outlook in housing--which played such an important role in recovery from the 1949, 1954, and 1958 recessions--is much less encouraging in 1961. Thus, the risk of bad timing of Government outlays is smaller in 1961 than it has appeared in any previous postwar recession. In our present circumstances we should not shrink from launching needed projects because of misplaced fears of bad timing.

The success of fiscal and budget policies cannot be measured only by whether the budget is in the black or in the red. The true test is whether the economy is in balance. Only an economy which is realizing its potential can produce the goods and create the jobs the country needs. If at the end of this year the unemployment ratio is still near 7 percent, our fiscal policies would have to be viewed with great concern, even if there is little or no deficit in the budget. On the other hand, if we have succeeded in reducing the unemployment ratio and expanding output significantly by year's end, we will be on our way to the goals of a stronger economy and the restoration of budgetary strength.

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Policy for Growth

For the near future, economic policy justifiably places first emphasis on measures to expand aggregate demand to levels that will overcome the recession and, in time, close the gap between actual and potential production. Since demand pushing hard on existing capacity stimulates investment in plant and equipment, measures for economic recovery form an essential part of a balanced program for economic growth. But at high levels of activity, the major emphasis of growth policy is necessarily focussed on the uses of our output, i.e., on the channeling of a larger share of our resources to the expansion and improvement of both the human skills and the physical capital of the country.

A basic component of any program for accelerated economic growth must be investment in the extension of knowledge, the general education of the population, and the training of the labor force. The improvement of technology and the increase of skills go hand-in-hand with ordinary capital formation to increase productive capacity. Their interaction is far more powerful than the sum of their independent effects. Technical advance without modernization of facilities loses much of its potential effect on output, and it has been observed that mere increase of capital without technological progress also has weak effects on productivity. But together they are responsible for the long-term growth of American productive potential.

It is a deeply-held American belief that education is a good thing in itself, both as the foundation stone of equality of opportunity and as an enrichment of everyday life. Continuing education of the labor force also makes a contribution to economic productivity. Literacy has economic, as well as social, value. In a qualitative way, we can easily imagine how hard it would be to operate an advanced industrial economy with a labor force in which the ability to read and to add or divide was a scarce commodity. More quantitatively, one recent study attributes a quarter of the growth-rate of the real national income since 1929 to the increase in the educational level of the labor force. While the United States now educates an unprecedented fraction of its citizens, there is more to be done in improving the amount and the quality of education. There are few activities which contribute in so many ways to strengthening the fabric of American society.

In his special message of February 23 on natural resources, the President announced that the Council would report to him, the Congress, and the public on the status of resource programs in relation to national needs. At the same time he mentioned estimates that by 1980 the Nation's consumption of water would double and of electric power would triple. These, like forests, are renewable resources. But the consumption of metals and other minerals will also increase and the domestic supply of these resources is ultimately fixed. Here wise management must take the form of promoting rational use and developing access to leaner sources of supply. Research and the development of new technology will play a fundamental part in this important aspect of economic growth.

Effective translation of advances in knowledge and technology into advances in the quantity and quality of output requires additional business investment. As noted earlier, the fraction of our GNP devoted to investment in plant and equipment has been declining since 1948. If we choose as a Nation to accelerate our rate of economic growth and productivity increase, we must reverse the tendency of our capital stock to age. This will require an increase in the rate of investment relative to GNP, perhaps beyond the levels of early postwar years. Some of this investment will be for expansion of capacity and some to give effect to technical progress and potential increase in productivity.

The revenue-raising power of the existing Federal tax system can be an important asset in achieving the levels of investment needed for rapid advance in productive capacity. First, the potential high-employment surplus can be used, as discussed above, to finance the desirable Government programs which contribute to the build-up of human capital. Second, it can indirectly increase incentives for private investment by facilitating a policy of relative monetary ease, as noted in the preceding section. Third, it can be placed at the disposal of the economy for investment purposes by the process of debt retirement. When the Federal Government retires debt it, in effect, exchanges cash for an asset which had been a store of wealth for the owners of the debt. These owners then seek other assets to hold, primarily the debt and equity securities of business firms and the bonds of State and local governments. In other words, the debt retirement process channels savings into uses which facilitate investment for economic growth.

In addition, the tax system can be used to provide specific financial incentives for investment. In his Economic Message, the President announced that he would propose a modification of the income tax law to favor investment in plant and equipment. This can be done in such a way as to yield strong incentive effects per dollar of revenue loss. Accompanying measures would restore the revenue loss and improve the fairness of the tax system.

Measures to stimulate business investment directly will contribute to our recovery from the present recession, but that is not their main purpose. All who have confidence in the American economy must look ahead to the day when the slack will be taken up and high levels of output and employment will again be the rule. The full benefit of our decision to supplement increases in consumer demand now with a higher rate of capital expansion and modernization will then be realized.

As noted earlier, these efforts to step up the rate of productivity increases have important implications for our balance of payments position. It is not the rate of increase in hourly wages which is directly relevant to the competitive position of our export and import-competing industries, but rather the movement of unit costs and prices. Wage rates in some industrialized countries have risen further than U. S. wages, but a high rate of productivity increase has held down costs and prices in these countries, with consequent benefit to their foreign trade position. A speeding up of the rate of productivity improvement in the United States would, by the same logic, strengthen the position of American industry in the international economy.

Price Stability

In his Economic Message of February 2, the President said:

"We must not as a nation come to accept the proposition that reasonable price stability can be achieved only by tolerating a slack economy, chronic unemployment, and a creeping rate of growth.

"Neither will we seek to buy short-run economic gains by paying the price of excessive increases in the cost of living. Always a cruel tax upon the weak, inflation is now the certain road to a balance-of-payments crisis and the disruption of the international economy of the Western World."

The task of reconciling full recovery and accelerated growth with reasonable price stability carries an urgency which justifies the emphatic tone of the President's language. The work of the Joint Economic Committee has been of major importance in extending awareness that inflation in America is not one problem but many, and that there is no single easy formula for achieving the reconciliation we all seek.

As we look ahead to the price problems of the next few years, the following considerations will contribute to a clearer appreciation of the issues:

1. By far the greater part of the postwar inflation occurred in two periods of over-all excess demand--the years 1946-48 and the period of the Korean conflict. If the problem should recur in this form, the powerful tools of fiscal and monetary policy are available, and will be used, to bring aggregate supply and demand into balance.

2. The inflation of the years 1955-58 cannot be characterized by any single label. Some price and wage increases in those years were delayed reactions to the earlier demand inflations. Others were compounded of temporary excess demand in some sectors, slow response of productive resources to secular shifts in demand, sluggish productivity gains in some industries, and the exertion of market power by some elements of labor and management.

3. The goal of reasonable price stability does not mean that no price should rise. It does mean that price increases for some goods and services, necessitated by smaller-than-average productivity gains or other causes, must be roughly balanced by price reductions of other goods or services, made possible by larger-than-average productivity gains or other factors. Moreover, price level stability is not the equivalent of absolute stability in the official price indexes; as noted in the Report of the Price Statistics Review Committee, which the Joint Economic Committee has just published, many experts believe that the price indexes, by failing to take full account of quality improvement, contain a systematic upward bias.

To create a climate which will reduce the likelihood of a repetition of the 1955-58 experience, public and private policy should focus on several objectives:

First, the forces of competition should be strengthened by the vigorous enforcement of the antitrust laws and by other appropriate means. Some excessive price increases in 1955-58 might not have occurred if market control had not been so strong.

Second, continuing efforts should be made to enlist the cooperation of labor and management in a voluntary program of price and wage restraint. In this connection, the President has appointed an Advisory Committee on Labor-Management Policy which will concern itself, among other things, with actions that may be taken by labor, management, and the public to promote sound wage and price policies.

Third, a higher rate of productivity increase should be sought, not only for the direct benefits which higher productivity will yield, but also because a highly progressive economy is able to absorb steadily rising wage rates into a stable price level. The President's Labor-Management Committee will also seek to achieve agreement on methods of raising productivity.

Fourth, efforts should be made to foresee emerging needs for skilled manpower, to aid in the adaptation of skills to present and prospective demands, and to promote geographical and occupational mobility. For example, because the supply of medical services has not responded adequately to a steady increase in demand, sharply rising costs of medical care have contributed to the increase in consumer prices. In this connection, the President has proposed legislation to support the expansion of medical and dental education facilities and, through a program of scholarships, to increase the number of new doctors and dentists graduated each year. Studies are also under way looking toward the modernization and redirection of the National Vocational Education Act. Programs of this sort, modest though they may be, can increase the resiliency and efficiency of the economic system and strengthen its resistance to price increases.

IV. SUMMARY AND CONCLUSION

As we review the state of the economy and the policies for recovery and growth, these points stand out:

1. The recession itself, while not as severe as the other three post-war recessions, has proceeded steadily since last spring. Current hopes for an economic upturn lie principally in a possible rise in consumer spending aided by the stimulus of the President's programs; the continued upward trend in local, state and Federal government purchases; and some prospect of an assist from inventories within several months.

2. An economic upturn would be only the beginning, not the end, of the solution to our economic problems. The recession followed an incomplete recovery in which the American economy fell substantially short of its potential levels of employment, production and income. Indeed, the gap between what we <u>are</u> producing and what we <u>can</u> produce reached 8 percent at the end of 1960. Today, it may be even closer to the 10 percent gap that developed at the worst stage of the 1958 recession. Taking up this slack of some $50 billion in economic activity, rather than merely reversing the economic decline, is the real challenge of economic policy in the months ahead.

3. In addition to the problems of recession and slack, we are confronted with a disturbing slowdown in the rate of growth of our national economic potential. The rate at which the stock of the

country's capital has been expanded and modernized has slowed down in the face of unused capacity, with a consequent slackening of growth in productivity. Also, we have not made full use of possibilities for increased investment in human capital through education, training, and research.

4. The risk of bad timing of government outlays--in the sense that anti-recession projects may have a delayed impact which will aggravate an inflationary boom--is smaller in 1961 than it has appeared in any previous postwar recession. Given the continued and stubborn problem of economic slack--and given the less encouraging outlook for the housing sector, which played such a major role in the early phase of the 1958 recovery--one can only conclude that we must not shrink from launching needed projects because of misplaced fears of bad timing.

5. Substantial opportunities exist in the field of monetary policy, debt management and housing credit to contribute to economic recovery and growth. The Federal Reserve and the Treasury are pursuing policies to reduce the cost and increase the flow of long-term credit while keeping short-term interest rates from falling to levels which would lead to further withdrawals of short-term capital. With the support of the general measures to lower the cost of long-term credit, specific steps are being taken to lower mortgage rates and increase the availability of funds to home-builders.

6. The President's programs, which promise substantial support to consumer income and demand, can be a major factor in strengthening the American economy in the months ahead. However, the President, in his February 2 message, stated: "If economic developments in the first quarter of this year indicate that additional measures are needed, I will promptly propose such measures." A further program for economic recovery might consider a speed-up in government construction and related projects, an expansion of housing programs, and tax reduction. Temporary income tax cuts, in particular, provide a fast method for enlarging the private income stream and speeding recovery. At the same time, the temporary nature of such a tax reduction would preserve the basic revenue-raising power of the tax system for later use in financing government programs, retiring debt, and stemming inflation. Whether such additional stimulative measures will be needed depends, as the President has indicated, on further economic developments.

7. In pursuing the expansionary policies required by the serious economic problems we face, we cannot lose sight of the possible impact of those policies on domestic price levels and our balance of payments. We do not accept the gloomy doctrine that economic expansion is inherently inconsistent with reasonable price stability and balance in our international accounts. For example, added investment to stimulate increases in productivity, with consequent reductions in cost, simultaneously serves all

three objectives. In addition, the work of the President's Advisory Committee on Labor-Management Policy gives promise of improvement in public and private policy for maintaining price stability.

8. Together with policies to reverse the recession, close the employment and production gap, and maintain reasonable price stability, it is important to initiate further steps to promote faster economic growth. These would include tax incentives to stimulate business investment and expanded programs in education, training, and research to build up America's human capital.

* * * *

The foregoing considerations underscore the importance of the economic goals placed before the Nation in the President's February 2 message to Congress:

> "Realistic aims for 1961 are to reverse the downtrend in our economy, to narrow the gap of unused potential, to abate the waste and misery of unemployment, and at the same time to maintain reasonable stability of the price level. For 1962 and 1963 our programs must aim at expanding American productive capacity at a rate that shows the world the vigor and vitality of a free economy. These are not merely fond hopes, they are realistic goals. We pledge and ask maximum effort for their attainment."

Supplement A

Relationships among Potential Output, Actual Output, and Employment

This Supplement gives a full description of the theoretical and statistical procedures underlying the estimates of potential output and degree of slack reported in the text. Calculations like this are at best hazardous and uncertain and ours do not pretend to be definitive. Work along these lines is proceeding at the Council and elsewhere and further reports will describe the results.

Table 3 of the text shows the sources of the 8 percent potential increment in output during the last quarter of 1960. In addition to the reduction of unemployment, a rise in output would be accompanied by (a) an increase in the civilian labor force; (b) a rise in hours per man; and (c) a marked increase in output per man-hour.

(a) Labor Force - In his testimony to the Joint Economic Committee, February 9, 1961, Ewan Clague, Commissioner of Labor Statistics, showed that the actual labor force has fallen considerably below trend projections during the past 3 years. This shortfall is attributable to the disappointing performance of the economy; many people have stayed out of the labor market although they would take employment if jobs were available. Following Mr. Clague's calculations, we estimate that the labor force associated with capacity output at the end of 1960 would have been higher by 561,000 persons, or 0.8 percent as shown in Table 3.

(b) Hours - There has been a desirable secular decline in hours worked per man, as progress has made possible increased voluntary leisure. On the average, in the 1947-59 period, hours per man in the private sector fell by 1/3 of 1 percent per year, while GNP rose at a 3.6 percent annual rate. However, hours per man fell more rapidly when the growth of GNP was below its average. And increases in real output have been associated with relatively small declines, or even rises, in hours per man. The indicated 1.2 percent increment of GNP due to increased hours of work per man is based on the estimate that each one percent difference in output-growth is associated with a difference of 0.14 percent in hours per man, including both overtime and part-time work. The estimate is necessarily tentative and inexact because of the incomplete nature of the economy-wide data on man-hours.

The figure of 0.14 is obtained by fitting a least-squares regression line to annual data for 1947-59. The data are found in the Bureau of Labor Statistics Release (USDL-4155) of June 28, 1960. The variables are percent change in man-hours of work per person employed (Y) and percent change in private nonagricultural output (X), restricted to private nonagricultural output and employment; establishment figures are the source of the man-hour estimates. The fitted line is:

$$Y = -.843 + .142X \quad (r = .85)$$

According to this relationship, annual hours per man remain constant from one year to the next when output rises by 6 percent. On the other hand, if output declines over a year by 1 percent, man-hours per man will also fall by 1 percent. When the equation is used to compare different possible outputs at the same point in time, it supports the estimate in Table 3.

(c) Productivity - The rate of productivity growth in the postwar period has shown a consistent and close relationship to the rate of expansion of output. The economy uses labor more efficiently as it utilizes its productive capacity fully. Recessions produce "on-the-job under-employment." In many firms, a substantial part of the work force is essentially a fixed cost in a period of recession. A manufacturing firm which cuts its production by 10 percent in a recession ordinarily finds it difficult or impossible to curtail significantly its clerical help, its managerial or supervisory personnel, or its sales force. It may also be reluctant to lay off production workers, both to maintain morale and to avoid the expense of hiring and training new labor when business activity recovers.

Just as productivity is retarded by economic slack, large gains in output per man occur with a return toward full utilization of resources. Table A-1 shows the increase in real GNP, employment, and output per employed person for the first year of each of the three postwar cyclical recoveries.

Table A-1. Increase of Product Per Man in Three Postwar Expansions

(Percent)

Item	1949-IV to 1950-IV	1954-III to 1955-III	1958-II to 1959-II
Rise in real gross national product	13.1	9.5	10.1
Rise in employment	3.6	4.7	3.3
Rise in real gross national product per person employed	9.1	4.5	6.5

Source: Council of Economic Advisers (based on Department of Commerce and Department of Labor data).

In each expansion, output per man grew by more than its postwar trend. The average gain in the three recovery years is nearly 7 percent, while the trend growth in output per man for the entire postwar period is slightly over 2 percent. Reduction in unused capacity is responsible for the extra 5 percent gain in output per man. Translated into a gain of output per man-hour, the five percent increase in output per man is somewhat above the 3.3 percent increment in man-hour productivity shown in Table 3 of the text.

The data for the entire postwar period offer solid confirmation of the relationship between productivity gains and the growth of total production. One piece of evidence is supplied by a statistical estimate derived from quarterly data for real GNP and total civilian employment covering 1947 II to 1960 IV. The variables are percent change in output per person employed (Y), and percent change in real GNP (X). The 55 quarterly observations yield the following relationship:

1) $Y = .02 + .66X \quad (r = .86)$

According to this equation, a rise of 1 percent in output requires an increase in employment of only one-third of 1 percent.

Two further statistical relationships are derived from data on unemployment and real GNP. One of these is shown as Chart 5 of the text above. It relates the ratio of unemployed to the civilian labor force (Y) to the percentage gap in actual output (X), as measured from the 3.5 percent trend line through mid-1955, with quarterly data for 1953 to 1960. The resulting equation is:

2) $Y = 3.72 + .36X \quad (r = .93)$

Here, each extra 1 percent of output is associated with a decline of 0.36 percentage points in the unemployment ratio.

The third statistical relationship is based on data for the change in the percent of the labor force unemployed (Y) and the percentage change in real GNP (X). With 55 quarterly observations from 1947-II to the end of 1960, the estimated regression line is:

3) $Y = .30 - .30X \quad (r = .79)$

The estimated unemployment ratio is lower by 0.3 points for each one percent rise in output.

Equations 1) through 3) all have implications for the rise in man-hour productivity that could be expected to accompany an 8 percent increment in output. To compare these implications directly, certain adjustments are necessary. Equation 1) is given in terms of output per man, and must be amended for the rise in man-hours per man. Equations 2) and 3), which are based on the unemployment ratio, require adjustment for both increases in the labor force and rises in hours per man. With the adjustments, an increase of 8 percent in output would raise productivity as follows:

Equation	Expected percentage rise in output per man-hour
(1)	4.2
(2)	3.0
(3)	3.3

These results differ somewhat but agree in showing a substantial gain in productivity. The 3.3 percent increase used in Table 3 of the text lies near the middle of the alternative estimates.

To summarize, the estimate of the ratio of potential GNP to actual is obtained as the product of the ratios of potential to actual labor force, employment, hours per man and output per man-hour.

Trend Projections of Recent Growth

Table A-2 shows the annual rate of growth of selected magnitudes from the first quarter of 1947 to the last quarter of 1960. It also divides the period into halves, using the last quarter of 1953 as a dividing line.

Table A-2. Annual Rates of Growth of Output and Employment

(Percent per annum)

Item	1947-I to 1960-IV	1947-I to 1953-IV	1953-IV to 1960-IV
Gross national product in constant dollars.........	3.4	4.3	2.5
Employment................	1.1	1.1	1.2
Gross national product per person employed......	2.2	3.2	1.3
Civilian labor force......	1.3	1.1	1.6

Source: Council of Economic Advisers (based on Department of Commerce and Department of Labor data).

The growth in productivity and output decelerated in the last half of the period while the growth rate of the labor force increased for demographic reasons. The 1.5 percent growth rate of the labor force used in the text is consistent with experience of the last several years. The present trend rate of growth of output per person employed has been taken in the text as 2 percent. This is considerably above recent experience. The low rate of productivity growth in recent years is, in part, attributable to the increasing gap between actual and potential output; but it also, in part, reflects a lower rate of growth of potential output. The close relationship shown in Charts 4 and 5 between the calculated gap and unemployment ratios offers support for the estimate of a 3.5 percent rate of growth in potential output.

Real GNP per person employed rises at a lower rate than output per man-hour in the private sector. With annual data for 1947 to 1959, the annual growth of real GNP per man was 2.5 percent, while gross private product per man-hour rose at a 3.2 percent rate. About half of the difference between the two figures is attributable to the secular decline in hours of work per person employed; the other half is accounted for by output and employment in government. Definitions of government output are such that the productivity gain in the government sector is necessarily negligible.

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Supplement B

Unemployment and the Structure of the Labor Force

The question sometimes arises whether the obstinate refusal of the unemployment rate to decline below 5 percent since the end of 1957 is a consequence of long-term "structural" changes in the age, sex, and other composition of the labor force, and not of weakness in aggregate demand. If this were so, it would mean that measures to stimulate the general level of economic activity might fail to get the over-all unemployment rate down to tolerable levels. Indeed, as the cyclical component of unemployment vanished, leaving only the "hard core," the result might be inflationary wage increases.

But this argument can be shown to be false. There is little evidence that current unemployment is unusually concentrated in particular compartments of the labor force, whether age, sex, color, marital status, or education. Nor can the current level of unemployment be attributed to certain industry or occupation groups. There is little evidence that current unemployment is primarily a result of unfavorable changes in the labor force. The evidence is that our high over-all rate of unemployment comes from higher unemployment rates group by group, category by category, throughout the labor force.

We begin by looking at the age and sex composition of the unemployed in say, 1957 and 1960. If the "hard core" argument were true, women and older workers ought to be a larger fraction of the unemployed group in the later year. But, as Table B-1 shows, the age and sex distribution of the unemployed is essentially the same in the two years. Indeed, workers in the over-65 age group formed only 3.1 percent of the body of unemployed in 1960 as against 3.8 percent in 1957. There is an approximately compensating increase in the proportion of workers under 24 among the unemployed: 34.2 percent in 1957, 35.0 percent in 1960. As for the breakdown by sex, women were 35.3 percent of the unemployed in 1960 and 35.6 percent in 1957. Clearly there is little or no difference between the two years and what there is does not especially favor the "hard-core" hypothesis.

Another way of looking at the data is shown in Table B-2. The over-all unemployment rate was 5.6 percent in 1960, 4.3 percent in 1957, an increase of about 30 percent. We can make a similar calculation for each age-sex category, and observe which ones show a substantially greater-than-30 percent increase in the incidence of unemployment. It turns out that the oldest age groups of both sexes had below-average increases in unemployment rate, and the largest increase in incidence was suffered by men in the 24-34 year age group.

When we turn to other labor-force categories, the statistical evidence has similar implications. We can compare unemployment rates by industry (Table B-3) and by occupation (Table B-4) in 1957 and 1960.

We find that even in those industries and occupations which have been enjoying secular expansion the incidence of unemployment has increased as much or almost as much as for the whole labor force. In trade, in finance, insurance, and real estate, even in public administration; among professional and technical workers, among managers, officials and proprietors, among white-collar workers in general, unemployment rates have gone up at about the same rate as for other occupations.

To probe more deeply into the effect of labor force changes on unemployment, and to carry the analysis back to 1953, we can perform an experiment. For 1953, 1957 and 1960 we classify the labor force by important demographic or economic characteristics: age, color, marital status, educational attainment, occupation and industry, and in each case we cross-classify by sex. For each year we also have the unemployment rate within each category.

Suppose that in 1960, unemployment rates for each age-sex category had been the same as they were in 1957. The age-sex composition of the 1960 labor force was, however, different from 1957. If we hypothetically apply the 1957 unemployment rates to the actual 1960 labor force, we calculate what 1960 unemployment would have been with the 1957 age-specific unemployment rates. How much of the actual increase in unemployment for the second quarter of 1957 to the second quarter of 1960 is accounted for in this way? The answer is given in the first column of Table B-5. Actual unemployment increased by 933,000. With the 1957 rates and the 1960 labor force, unemployment would have increased by 185,000. This measures the increase in unemployment attributable purely to changes in the age-sex structure of the labor force. Fully 80 percent of the increase is a consequence of increased unemployment rates. Only 20 percent of the increase would have occurred had unemployment rates remained constant at 1957 levels.

The second column of Table B-5 shows what happens when 1960 unemployment rates are applied to the 1957 labor force. The results are broadly similar. About 22 percent of the observed increase in unemployment is attributable to changes in the age-sex composition of the labor force. By far the greater part is a consequence of higher unemployment rates, age-group by age-group.

The third and fourth columns of Table B-5 answer the same question in a comparison of the second quarter of 1953 with the second quarter of 1960. Only between 12 and 22 percent of the two-million increase in unemployment is structural. The rest is cyclical.

Table B-6 puts these answers in terms of unemployment rates. The rate of unemployment increased by 1.14 from 1957 to 1960. Between .09 and .14 of that increase is structural. The remaining increase of 1.00 or 1.05 is cyclical.

Together Tables B-5 and B-6 cover the effects of changes in the age, color, occupational and industrial composition of the labor force. In all cases, the labor force effects are weaker than those for age. The inescapable conclusion is that observed changes in unemployment and unemployment rates are overwhelmingly the result of increases in the category-by-category unemployment rates and only to a minor extent due to structural factors.

Tables B-7 and B-8 repeat the analysis for the factors marital status and educational attainment, and with the same results. Indeed, the observed changes in the educational attainment of members of the labor force would by themselves have reduced unemployment rates between 1953 and 1960, and again between 1957 and 1960.

It must be granted that some structural unemployment will not show up in the data, because older workers and possibly very young workers may leave the labor force in the absence of demand for their services. The 1960 labor force is indeed below trend in the male 14-19 and 65-and-over age classes. A rough calculation suggests that if the "missing" workers were put back in the 1960 labor force, the 1957 rates might account for only another 29,000 of the 1960 unemployed.

We stress that in a test like this the cards are stacked <u>in favor</u> of the theory of increasing hard-core unemployment, and still it fails. Any student of the workings of a free enterprise market economy will see this at once. Workers in one age group are after all fairly close substitutes for workers in neighboring age groups. The same is true for the other classifications studied. When supply conditions change, with one group increasing more rapidly than another, market forces will induce some offsetting wage changes. They need not restore the old over-all unemployment rate; the point is that some equilibration occurs in the market. The test we have performed leaves this out of account. It assumes that extra workers in any age-sex class, or occupational group, or other category cannot increase their chances of finding employment by accepting lower wages, or working inconvenient hours, or in any other way. Even so, it appears that changes in the demographic occupational and industrial make-up of the labor force are a minor source of increased unemployment.

What are we left with? We are left with the fact that in 1960, there was more long-term unemployment than in 1957, as shown in Table B-9. In 1960, 24.3 percent of the unemployed were unemployed 15 weeks or more, against 19.1 percent in 1957. Of these, 11.5 percent were unemployed for 27 weeks or more in 1960, against 8.1 percent in 1957. Does this entail that in 1960 more of the unemployed were in fact unemployable? Not at all. Even if spells of unemployment were distributed at random through the labor force, each member subject to the same risks, an increase in the over-all unemployment rate would inevitably show up in a higher average duration of unemployment and a larger number of longer spells of unemployment. The increase in long-term unemployment may simply signify that jobs were harder to get for everyone, not that there is a special class of people called "long-term unemployed" who are increasing in number.

Finally, we turn to a pressing aspect of the problem of cyclical and structural unemployment, the existence of chronically distressed labor markets, or what the Department of Labor calls areas of substantial and persistent labor surplus. These are labor market areas which at any time whose unemployment rates are above 6 percent for other than temporary reasons and have been 50 percent or more above the national average for an extended period of time. In November 1960, the areas in this category, large and small combined, had 7.3 percent of the national labor force and 12.2 percent of the unemployment.

It is noteworthy that over the years the labor force in the major labor surplus areas has been declining, counter to the movement of the national labor force. In the 17 major areas in this classification as of January 1961, the total labor force declined by 6.3 percent in the 7 years from May 1953 to May 1960, while the national civilian labor force was increasing by 11.1 percent. It is not known how much of the decline represents a movement to disguised unemployment in rural areas, or a withdrawal of persons from the labor force because of the lack of job opportunities.

Whatever the economic situation, there will always be areas with above average unemployment rates. And as industries decline because of technological change and shifts in demand, there will inevitably be some areas in which unemployment persists. The important question to answer is whether the magnitude of the distressed-area component of unemployment has been increasing over time, whether this structural aspect of the problem of unemployment is now a larger part of the whole than it once was.

This question is answered in Table B-10. The answer is that the major labor surplus areas always suffer relatively more than the country as a whole when the national unemployment rate rises, but the size of the differential does not appear to have increased since 1953.

The Table refers to the 17 major areas of substantial and persistent labor surplus as of 1961. It shows clearly the relatively greater fluctuation in unemployment rates to which they have been exposed since 1953. These fluctuations themselves show that there is large cyclical unemployment even within the labor surplus areas. For the 17 areas combined Table B-10 gives the percentage by which the unemployment rate in these areas exceeded the national average in each period. These percentages show no tendency to increase over time. The excess was especially high in May 1958, but in May 1960 it fell below what it had been at the previous business cycle peak in May 1957. The extraordinarily high excess in 1958 is largely due to the extremely severe unemployment rate - 18.3 percent in the Detroit area in that year; passenger car production fell by about a third from 1957 to 1958. If Detroit is removed from the group of 17 areas, it is seen that the excess unemployment rate for the remaining areas behaves quite uniformly over the period. It was 72 percent, 68 percent and 67 percent in the three business cycle peak periods of May 1953, May 1957 and May 1960. It was 81 percent in May

1954, 89 percent in May 1958, and 81 percent in November 1960. There is no indication that this structural aspect accounts for more of the unemployment problem than it did in the two earlier business cycles.

At the end of this long argument it is worth saying that it is no part of our intention to cry down structural unemployment or explain it away. The problems of younger and older workers, of nonwhite members of the labor force, of the technologically displaced, and of the distressed need to be attacked at the source. But our concern for them ought not to divert our attention from the real cause of weakness in 1961's labor market--and that is inadequate demand.

Table B-1. Unemployment by Age and Sex, 1957 and 1960

Age and sex	1957		1960	
	Thousands of persons	Percent of total	Thousands of persons	Percent of total
Total unemployment....	2,936	100.0	3,931	100.0
Young workers......	1,003	34.2	1,373	35.0
14 to 19 years..	573	19.5	790	20.1
Male.........	351	12.0	480	12.2
Female.......	222	7.6	310	7.9
20 to 24 years..	429	14.6	583	14.8
Male.........	283	9.6	369	9.4
Female.......	147	5.0	214	5.4
Adult workers......	1,931	65.8	2,553	64.9
25 to 64 years..	1,820	62.0	2,432	61.9
Male.........	1,175	40.0	1,593	40.5
Female.......	645	22.0	839	21.3
65 years and over...........	111	3.8	121	3.1
Male.........	83	2.8	96	2.4
Female.......	28	1.0	25	.6

Note.--Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

Table B-2. Unemployment rates by age and sex, 1957 and 1960

Age and sex	Unemployment rate (percent) 1/		Percentage change
	1957	1960	
Total	4.3	5.6	30
Male	4.1	5.4	32
14 to 19 years	11.3	14.0	24
20 to 24 years	7.8	8.9	14
25 to 34 years	3.3	4.8	46
35 to 44 years	2.8	3.8	36
45 to 54 years	3.3	4.1	24
55 to 64 years	3.5	4.6	32
65 years and over	3.4	4.2	24
Female	4.7	5.9	26
14 to 19 years	10.1	12.9	28
20 to 24 years	6.0	8.3	38
25 to 34 years	5.3	6.3	19
35 to 44 years	3.8	4.8	26
45 to 54 years	3.2	4.2	31
55 to 64 years	3.0	3.4	13
65 years and over	3.4	2.8	-18

1/ Percent of civilian labor force in each age group who were unemployed.

Source: Department of Labor.

Table B-3. Unemployment Rates by Occupation, 1957 and 1960

Occupation	Unemployment rate (percent) 1/		Percentage change
	1957	1960	
Total..................................	4.3	5.6	30
Professional, technical, and kindred workers..............................	1.2	1.7	42
Farmers and farm managers.............	.3	.3	0
Managers, officials, and proprietors, except farm.........................	1.0	1.4	40
Clerical and kindred workers..........	2.8	3.8	36
Sales workers.........................	2.6	3.7	42
Craftsmen, foremen, and kindred workers..............................	3.8	5.3	40
Operatives and kindred workers........	6.3	8.0	27
Private household workers.............	3.7	4.9	32
Service workers, except private household..........................	5.1	6.0	18
Farm laborers and foremen.............	3.7	5.2	40
Laborers, except farm and mine........	9.4	12.5	33

1/ Percent of civilian labor force in each category who were unemployed.

Source: Department of Labor.

Table B-4. Unemployment Rates by Industry, 1957 and 1960

Industry	Unemployment rate (percent) 1/		Percentage change
	1957	1960	
Total 2/	4.3	5.6	30
Experienced wage and salary workers	3.9	5.7	46
Agriculture	6.7	8.0	19
Nonagricultural industries	4.5	5.6	24
Mining, forestry, and fisheries	6.3	9.5	51
Construction	9.8	12.2	24
Manufacturing	5.0	6.2	24
Durable goods	4.9	6.3	29
Nondurable goods	5.3	6.0	13
Transportation and public utilities	3.1	4.3	39
Wholesale and retail trade	4.5	5.9	31
Finance, insurance, and real estate	1.8	2.4	33
Service industries	3.4	4.1	21
Public administration	2.0	2.6	30

1/ Percent of civilian labor force in each category who were unemployed.
2/ Includes self-employed, unpaid family workers, and persons without previous work experience not shown separately.

Source: Department of Labor.

Table B-5. Net Change in Unemployment by Age, Sex, Color, Occupation, and Industry, Selected Periods, 1953-60

(Thousands of persons)

Characteristic	Second quarter 1953 to second quarter 1960		Second quarter 1957 to second quarter 1960	
	Standardization method I	Standardization method II	Standardization method I	Standardization method II
Actual change (all workers)...............	2,119	2,119	933	933
Change resulting from change in labor force size and composition by:				
Age and sex.......	249	473	185	221
Color and sex.....	201	409	124	156
Occupation and sex 1/...........	129	190	92	108
Industry and sex 2/	198	337	145	153

1/ Data relate to experienced workers in April. Actual changes were 1,577 for 1953-60 and 835 for 1957-60.

2/ Data relate to experienced workers. Actual changes were 1,628 for 1953-60 and 705 for 1957-60.

Source: Department of Labor.

Table B-6. Net Change in Unemployment Rates by Age, Sex, Color, Occupation, and Industry, Selected Periods, 1953-60

(Percent)

Characteristic	Second quarter 1953 to second quarter 1960		Second quarter 1957 to second quarter 1960	
	Standardization method I	Standardization method II	Standardization method I	Standardization method II
Actual change (all workers)	2.70	2.70	1.14	1.14
Change resulting from change in labor force size and composition by:				
Age and sex	.07	.38	.09	.14
Color and sex	.00	.29	.00	.05
Occupation and sex 1/	-.06	.03	-.01	.01
Industry and sex 2/	.04	.24	.07	.08

1/ Data relate to experienced workers. Actual changes in the rate were 2.03 for 1953-60 and 1.06 for 1957-60.

2/ Data relate to experienced workers. Actual changes in the rate were 2.07 for 1953-60 and 0.86 for 1957-60.

Source: Department of Labor.

Table B-7. Net Change in Unemployment by Marital Status and Education, Selected Periods, 1953-60

(Thousands of persons, 14 years of age and over)

Characteristic and change	April 1953 to March 1960		March 1957 to March 1960	
	Standardization method I	Standardization method II	Standardization method I	Standardization method II
Marital status and sex:				
Actual change (all workers).	2,419	2,419	1,324	1,324
Change resulting from change in labor force size and composition by marital status and sex	170	331	154	139
	October 1952 to March 1959		March 1957 to March 1959	
Educational attainment and sex:				
Actual change (workers 18 years old and over)	2,719	2,719	1,445	1,445
Change resulting from change in labor force size and composition by education attainment and sex	75	85	-13	6

Source: Department of Labor.

Table B-8. Net Change in Unemployment Rates by Marital Status and Education, Selected Periods, 1953-60

(Percent)

Characteristic and change	April 1953 to March 1960		March 1957 to March 1960	
	Standardization method I	Standardization method II	Standardization method I	Standardization method II
Marital status and sex:				
Actual change (all workers)	3.24	3.24	1.77	1.77
Change resulting from change in labor force size and composition by marital status and sex	.01	.24	.09	.07
	October 1952 to March 1959		March 1957 to March 1959	
Educational attainment:				
Actual change (workers 18 years old and over)	3.96	3.96	2.11	2.11
Change resulting from change in labor force size and composition by educational attainment and sex	-.06	-.04	-.11	-.08

Source: Department of Labor.

Table B-9. Unemployment by Color and Sex, and Duration of Unemployment, 1957 and 1960

Duration of unemployment, and color and sex	1957		1960	
	Thousands of persons	Percent of total	Thousands of persons	Percent of total
Total unemployment	2,936	100.0	3,931	100.0
Color and sex:				
White	2,350	80.0	3,127	79.5
Male	1,519	51.7	2,032	51.7
Female	832	28.3	1,095	27.9
Nonwhite	585	19.9	804	20.5
Male	374	12.7	508	12.9
Female	211	7.2	295	7.5
Duration:				
Less than 5 weeks	1,485	50.6	1,799	45.8
5 to 14 weeks	890	30.3	1,176	29.9
15 weeks and over	560	19.1	956	24.3
15 to 26 weeks	321	10.9	502	12.8
27 weeks and over	239	8.1	454	11.5
Average duration (weeks)	10.4		12.8	

Note.--Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

Table B-10. Cyclical Fluctuations of Unemployment in the National Economy and in Major Areas of Substantial and Persistent Labor Surplus

Labor force and unemployment by area	Unit	May 1953	May 1954	May 1957	May 1958	May 1960	Nov. 1960
National totals:							
Civilian labor force	Thousands	63,285	64,425	67,893	68,965	70,667	71,213
Unemployment	Thousands	1,571	3,690	2,715	4,904	3,459	4,031
Unemployment rate	Percent	2.5	5.7	4.0	7.1	4.9	5.7
17 Major areas of substantial and persistent labor surplus: 1/							
Civilian labor	Thousands	4,138	4,082	4,108	4,156	3,879	3,848
Unemployment	Thousands	133	397	277	633	303	354
Unemployment rate	Percent	3.2	9.7	6.7	15.2	7.8	9.2
Percentage excess over national rate	Percent	28	70	68	114	45	61
Detroit:							
Civilian labor force	Thousands	1,523	1,499	1,528	1,528	1,403	1,391
Unemployment	Thousands	20	132	104	280	99	102
Unemployment rate	Percent	1.3	8.8	6.8	18.3	7.1	7.3
Pittsburgh:							
Civilian labor force	Thousands	962	935	924	973	948	943
Unemployment	Thousands	26	78	35	109	71	109
Unemployment rate	Percent	2.7	8.3	3.8	11.2	7.5	11.6
16 major areas without Detroit: 1/							
Civilian labor force	Thousands	2,650	2,583	2,580	2,628	2,476	2,457
Unemployment	Thousands	113	265	173	353	204	252
Unemployment rate	Percent	4.3	10.2	6.7	13.4	8.2	10.3
Percentage excess over national rate	Percent	72	81	68	89	67	81

1/ January 1961 classification. Data are for major mainland areas; exclude 3 areas in Puerto Rico.

Note.--There are also 83 smaller areas of substantial and persistent labor surplus having in November 1960 a total labor force of 2,393,000, total unemployment of 276,000, and rate of unemployment of 11.5 percent.

Source: Department of Labor.

Chairman PATMAN. Thank you, Dr. Heller.

Questions will be directed either to you, Dr. Tobin, or Dr. Gordon. It is desirable that each member of the committee have an opportunity to either make a statement or interrogate the witnesses, even though for a brief time. In order that each member may have such an opportunity, the Chair will request that not longer than 5 minutes be consumed by each member on the first go round. After that, each member will have more time.

Senator Douglas, would you like to ask some questions?

Senator DOUGLAS. Thank you, Mr. Chairman.

First, I would like to commend the group for the excellence of their report and also say that I think it is a very good thing that they testify in public so that their statements and conclusions can be subject to public scrutiny. The specific question that I would like to start off with is this:

On the basis of statistical evidence, you conclude that a change of 1 percent in the total volume of unemployment, that is an absolute change of 1 percent, is associated with a 3 to 3.5 percent change in real gross national product?

The conclusion, I think, which you draw is that if we could reduce unemployment from the January figure of 6.6 percent to 4 percent, that we would get an increase of something over 8 percent in the gross national product, or something over $40 billion.

This is the statistical material. I would like to ask what is the logic behind this. Why should the increase be a multiplier of the product rather than a mere addition?

Mr. HELLER. Senator, we have a table of the statement which might be the best way of addressing ourselves to the question you have just raised. It is table 3.

Senator DOUGLAS. Yes; I have found it.

Mr. HELLER. Sources of estimated potential, 8 percent increase of gross national product, fourth quarter of 1960. The first item is the reduction of unemployment itself, to 4 percent, which has an associated increase of output of 2.6 percent. That is simply the 2.6 percentage point increase in improvement in unemployment.

Two, the increase of labor force in response to greater demand. Statistical analyses of past increases in aggregate demand show that the labor force, itself, expands and is absorbed into employment.

Third, the increases of work-hours per man associated with higher utilization averages a little over 1 percent, 1.1, and then the largest single factor is the next one, the increase of productivity per man-hour associated with higher utilization.

As we pull out of recessions, slumps, inadequate levels of employment and production, the productivity per man-hour typically rises at a rate much faster than the trend rate. This is because there is fuller utilization of machinery and fuller utilization of the manpower on the job. There is a rather resistant level of employment of white collar and scientific and technical personnel who are not fully utilized in the period of softness in the economy. As the economy moves up to full employment, it capitalizes on their full capacities and contributions.

Senator DOUGLAS. Fuller utilization of the services of retail clerks, doctors, those who provide services.

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Mr. HELLER. And managerial personnel, the accountants and so forth and so on, are more fully utilized. They are on the job all through the slack, but as the economy moves back to a full production basis, they are making a greater contribution to the economy.

Senator DOUGLAS. Mr. Chairman, do I have time for another question?

Chairman PATMAN. I am sure you do have. Go ahead and ask it, anyway.

Senator DOUGLAS. I would like to ask a question about the proper method of financing investments by the Government. Suppose the Government decides to make loans to private individuals to be repaid with interest. How should the National Government get the money? By taxes or by borrowing?

Mr. HELLER. This is a question that raises the whole issue of the capital budget, of the loan process versus the appropriations process. We don't pretend to have any full answer to this. I might say that in Canada, for example, credit operations are outside of the regular budget and it is assumed that they be financed by separate borrowing and repayment operations, rather than as a charge against the budget, which is their target for tax purposes. This is true also in a number of European countries.

On the other hand, there are some fears—to try to give just a balanced, though very brief, answer—that if this method of financing is used, perhaps there would be something less than complete fidelity in the accounting for such loan expenditures. I am not sure whether this is a real or fanced danger. There is also the fear that if there is a fair amount of financing outside the regular budget, one may not have the same amount of fiscal control for economic stabilization purposes.

Whether these conflicting considerations can be reconciled is something that I don't think we are prepared to give any firm answer on. It has been alleged, of course, that forcing ourselves to finance capital investments, particularly investments in financial assets, by taxation, in effect, discriminates against those assets because it is harder to finance them by taxation than it is to finance them by borrowing. As I say, these are considerations on which no final answer is yet possible.

Chairman PATMAN. I assume, Dr. Heller, that you and your associates will be willing to answer any question that any member of our committee desires to ask you, and you will prepare the answer for the record when you correct the transcript, if we decide to submit questions to you in writing?

Mr. HELLER. Yes, within the limits of that tiny staff of ours, Mr. Patman.

Chairman PATMAN. We will bring that out later.

Mr. HELLER. I have a total of 12 economists on our staff. Within those limits we will be glad to help.

Chairman PATMAN. Senator Bush?

Senator BUSH. Dr. Heller, I noticed in the last 2 weeks in the New York Times business section that each of the last 2 weeks has shown a rather sharp increase in retail sales. Do you attach any significance to that in respect to the situation on the road to recovery at the present time or not?

Mr. HELLER. Senator, we are as much on the lookout for harbingers of spring in our economic outlook as you are. We are watching retail sales very carefully. We are watching the unemployment rate also, of course, very carefully, to the extent that it can be inferred from unemployment compensation statistics. There are a few signs in the economy that do give some hope of an upturn. At the same time, there still are some very soft spots that are not so reassuring. If the retail sales turn up on a seasonally adjusted basis, this will certainly be one of the good signs because the sag in retail sales has been one of the discouraging and disappointing factors in the past few months. An upturn here would be one of the signs that a recovery might not be many months off.

Senator BUSH. In the article they wrote about you in Time magazine, you seemed to feel that by the middle of the year we should be on the road to recovery. Is that correct?

Mr. HELLER. I want to underscore the statement that we have made in effect in several different ways in our prepared statement, that the upturn, itself, while it may come within the next few months, is the beginning and not the end of our problem of overcoming the present economic softness. But we do hope that in the factors that are now beginning to become evident in the economy an upturn may be in the making.

Senator BUSH. In the course of your statement, I thought you said that some people would fear that a substantial economic recovery or expansion here might hurt the balance of payment problem. Did I correctly understand you there?

Mr. HELLER. Yes, you did. May I refer this question to Mr. Tobin, who has been working in this area?

Senator BUSH. I would like to have an explanation of that, please.

Mr. TOBIN. The explanation would be that as our economy picks up, you could expect our demands for imports from foreign countries to pick up, too. The offsetting factor which we would hope for is that the investment in U.S. industry would become relatively more attractive compared with investment abroad and would keep some of our investment funds at home that have been in the past few years going to Europe, and attract long-term funds from Europe as well. How these two things would balance off in the full recovery, the increased imports on the one hand against the——

Senator BUSH. Don't you think, Professor, that real recovery increase in these indices, GNP, national income, and so forth, would, as your report suggests, fortify our fiscal position by making new income available to the Government and thus have a really constructive effect upon the balance of payment problem? It would tend to inspire confidence in our situation, which has been one of the problems, I believe, at least it seems to me that it has been, in connection with the balance of payments problem. It encouraged some speculation against the dollar and so forth. But don't you think that this would have a constructive and a strengthening effect on confidence if we go on the road to recovery?

Mr. TOBIN. I certainly do agree with that, Senator. The text tries to distinguish between a basic deficit in the balance of payments, which is due to the trade account and the long-term capital account and the Government's transactions, and the balance of payments deficit which is commonly quoted, which includes these volatile short-term capital movements. Those short-term capital movements were the main factor in the last half of 1960. We, of course, would expect that recovery and the restoration of confidence will bring some short-term capital back to the United States. But we did not count that as a part of the basic deficit, which represents the problem of our long-term international viability. That is a temporary influence which went against us in 1960, and we probably will have it going for us in 1961. There is a limit to the amount of short-term funds you can attract in that way.

Senator BUSH. I believe my time is up, Mr. Chairman.

Chairman PATMAN. Representative Bolling of Missouri.

Representative BOLLING. Mr. Heller, you point out that the Council has been given by the President additional responsibilities, and then in the last sentence of that first full paragraph you say:

We hope that it will be possible to restore the Council's staff at least to its size of 8 or 10 years ago so that the Council will be in a position to meet its full responsibilities.

Would you mind filling me in? I hate to confess this ignorance. Would you fill me in as to what the history of the size of the Council's staff has been?

Mr. HELLER. I can give you one general reference point, and that is that in 1952, before the Council was temporarily suspended, it had a staff of 19 economists.

There has been a gradual constriction of the staff until now, outside of the Council members and clerical and statistical staff, there are funds for only a dozen professional economists. So the staff has shrunk by more than one-third over this period of the 1950's.

I see in a table that Mr. Gordon just handed me that there were 19 professional experts in 1947. That figure held through 1952. Then since that time the attrition has carried farther than I thought. It carried to 11, rather than 12, which raises the percentage attrition considerably.

Representative BOLLING. Do I understand correctly that the change necessary to return to at least the same size staff would be an amendment to the Employment Act?

Mr. HELLER. I cannot say that I understand all of the congressional alternatives in trying to reach a higher level. I believe it would involve an amendment because we are up against the statutory $345,000 salary ceiling under the Employment Act of 1946.

Representative BOLLING. Is the Council in a position to say what it feels would be an adequate size staff to fulfill not only the old responsibilities, but the new ones?

Mr. HELLER. That question gives me a great deal of leeway, Congressman. What we have tried to do is posit a goal for staff restoration rather than expansion beyond the earlier level. All of us, of course, can answer in terms of considerably expanded terms when we see the things that could be done that are not being done.

But as our proximate goal for carrying out the responsibilities of the Council and particularly with the help of staff people in other departments, we feel that we could make a reasonably good try at it with an increase of about six or seven professionals on the staff.

Representative BOLLING. Thank you.

You mentioned in your statement, and I cannot identify the exact page, what, in effect, amounts to the position that today, unlike earlier postwar recessions, the problem of timing of expanded Government projects, et cetera, is by no means as acute as it was.

Would you mind expanding on that a little bit more so that I am sure I understand it? In effect, you are saying that we are not going to be contributing, by things that we start now, to inflation by the fact that they come more slowly than perhaps we would like them. Is that correct?

Mr. HELLER. Yes. We have this kind of thought in mind: If we were in essentially a V-shaped recession and recovery, if there were prospects for very rapid recovery carrying us all the way to full employment within a short span of months, then it surely would be unwise to undertake projects that might not mature until 12 or 18 months from now.

However, we face a gap of $50 billion between our current level of output and our potential level of output. We face a situation in housing, for example, that is a good deal more sluggish than it was in the previous postwar recessions.

There are other factors that seem to suggest that we have a very stubborn kind of problem of undercapacity and unemployment. In the light of these factors, in the light of the relatively intermediate-term job—I will not say longrun job but intermediate-term job, that faces us, the chances of our coming back to the full employment, full capacity level in a few months are much more limited than would call for a curbing of these programs on grounds that they might bear fruit in inflationary boom rather than restoring a stimulus to the economy.

Representative BOLLING. At one point I think you said undercapacity when I think you mean to say underutilization of capacity.

Mr. HELLER. Underutilization of capacity; thank you.

Chairman PATMAN. Representative Curtis.

Representative CURTIS. First, Mr. Chairman, I want to express surprise that we are going to have to combat Parkinson's law so early in the game. I would hope that we have an opportunity to examine the product that comes out of the Council of Economic Advisers before we go into the question of enlarging the staff.

I hope you will resist the temptation to increase until maybe you have been in the position over there for 4 or 5 months and then see whether it is necessary.

I would also say this: That I wish I could agree with Senator Douglas on the merits of the report. It is not that I disagree, but my mind is not quite as facile and I cannot absorb these 55 pages quite that quickly. In fact, I was going to make this suggestion, Mr. Chairman, that inasmuch as we have not had an opportunity to have had the testimony and the charts which have proved to be quite interesting ahead of time, and we have just skimmed over it, I wonder if it would not be possible that the Council could be invited back again in, say, a week or two, to give us an opportunity to ask the questions that should be asked.

I, myself, know just from a cursory reading of this that there are many questions that I would like to dig into. That is in the nature of a request, Mr. Chairman.

Chairman PATMAN. The request seems to me to be a reasonable one. If it is all right with the committee, we will arrange, if we can arrange time, at the convenience of the Council of Economic Advisers, that we will have another day.

Will that be satisfactory, Dr. Heller?

Mr. HELLER. We will be happy to do that.

Chairman PATMAN. We will proceed today as usual, but we will arrange another day and confer with you about it. We want it to be mutually satisfactory.

Representative CURTIS. To facilitate this, Mr. Chairman, because I have a feeling that at long last we are coming to grips with the differences and the reasons for the differences in the fundamental philosophy, I will encourage my side to perhaps prepare some questions ahead of time so that the doctor will have the benefit of them and we can come to grips.

There is a third statement I would like to make, and I made it on the floor of the House at the time the request was made to extend the time in which our committee makes their report to the Congress on the President's Economic Report, from March 1 to April 30.

I think it is quite unfortunate that this committee has not made a report up to date to the Congress, because so much of the President's legislation which has been submitted to us is predicated on an appraisal of our present economic situation.

In my judgment, it is a very wrong appraisal. I am happy to say that some of the statements made here about this being, up to date, anyway, the mildest of postwar recessions, is in contrast with some of the statements made in the President's first two economic messages, one in the state of the Union and the other, I think, billed as an economic message.

I think this gets it into better context. I am pleased along those lines. Coming to grips with this difference in philosophy, it comes down to this, it seems to me: We are both trying to measure the same thing, which is our economy, and when we come out looking at it in two such different ways, as I interpret your appraisal and those who follow your school of thought, you have used the word "soft." They have called our economy tired and sluggish.

One administrative spokesman, Mr. Walter Lippmann, actually called it sick. My appraisal of the economy is that it is dynamic, and the very problems that you see, and I see problems, I see them as a result of growing pains. In fact, I would say the more rapidly we grow the more difficult would become the problems.

So I think it is important to find out just what we are talking about. If the diagnosis of our economy is that we have a disease, then I would think that the remedy would be in the nature of drugs or even surgery. If it is a problem in the field of geriatrics, that we are getting old, maybe we need rehabilitation.

Certainly if it is a question of growing pains, then we have the problem that we have with raising adolescents, and those are quite complex and quite difficult. In one area, in the area of unemployment, I was very interested to hear you state that the figures completely prove that the problem in unemployment was not the result of rapid technological growth, but, rather, something else.

I shall be quite interested in examining into that because I reached just the opposite conclusion. But I would say this, and I have not had time to ask questions in 5 minutes, but only to make statements, that it is not just the skills that have been made obsolete that are a result of rapid technological advancement, but it is also the fact of the demand for people who are unskilled and the semiskilled that begins to disappear. There is not the demand in a rapidly growing and advanced society for people with no skills.

So we have to look at that sector as part of the result of a rapidly growing economy. Thirdly, I would observe that as an economy matures and improves in flexibility, there is a shift from the manufacturing sector to the service sector. We begin to see that, where employment has declined in manufacturing, but at the same time productivity has continued to increase, and even within the manufacturing sector the shift has been from blue collar to white collar workers.

But even in the recession, employment in the service areas has been increasing. Again I suggest a symptom of growing pains, rather than a disease of old age.

I think my time has now expired.

Chairman PATMAN. Concerning the day when we were asking you to give us the privilege of interrogating you about your statement, March 27, 3 weeks from today, we will hear Mr. Bell, Director of the Bureau of the Budget, and also Mr. Hitch, representing the Defense Department.

I wonder if the next day, the 28th, will be satisfactory with you, Dr. Heller? If so, we can agree to that now.

Mr. HELLER. I have just been checking with my two colleagues, who are delegates to meetings in Europe the preceding week, to see whether they will be back.

What Mr. Tobin says adds up that they will be back, but they will be tired.

Chairman PATMAN. We are all tired.

Mr. HELLER. We need to have some time for the responses to the questions.

Chairman PATMAN. We will talk to you further about it. We will not press the point now.

Mr. HELLER. May I put it this way: That if these questions will come to us promptly so that we can do our homework before they leave for their responsibilities at these meetings, we think the 28th might work out.

Chairman PATMAN. Senator Bush informs me that we have too many hearings going on to furnish the questions immediately. We will talk to you about a different date, Dr. Heller. Obviously this one will not be a satisfactory one.

Senator SPARKMAN. When do they leave for Europe, Mr. Chairman?

Mr. HELLER. The departure date would be the 18th, the week of the 18th or 19th. The 28th would be the end of the next week.

Chairman PATMAN. What about a date preceding that? Would that be satisfactory?

Representative CURTIS. Mr. Chairman, could I observe that inasmuch as our report does not have to go in now until April 30, time is not so pressing on this, although this should be done, in my judgment, to be of value, in sufficient time that we can utilize this material for our report.

Chairman PATMAN. It is possible that we can put this off until after the Easter recess. We will talk to you further about it.

Senator Sparkman?

Senator SPARKMAN. Dr. Heller, first I want to compliment you and your associates for this very fine statement. I think it is a fine, forthright statement, and I think it is most helpful to have it brought out here before the committee and in the public.

Mr. HELLER. Thank you.

Senator SPARKMAN. A while ago, Senator Douglas was asking you something about financing, about borrowing as well as taxation.

Senator DOUGLAS. Public investment.

Senator SPARKMAN. Yes. I gathered from your answer that you are not prepared to discuss that yet, so far as a basis of recommendation is concerned, but let me ask you this: You do consider that to be a question of importance and within the jurisdiction of your council to consider, do you not?

Mr. HELLER. When you put it that way, Senator, yes. It is a question within the jurisdiction of the council to consider; not to decide, but to examine.

Senator SPARKMAN. I realize that, but to advise the President on it. The reason I wanted to bring that up is this: Are there not some better financed governments of the world who do use a divided budget system, one for operation of the government and one for capital investments?

Mr. HELLER. Some of the Scandinavian countries in particular have a very highly developed capital budget system.

Senator SPARKMAN. Does England?

Mr. HELLER. England has a somewhat different divided budget, above and below the line. Below the line is particularly their nationalized industries. It is sort of halfway between what we do and what the Scandinavian countries do.

Senator SPARKMAN. Yes. I do not care about going into a discussion of it further, but I want to say this: that I think it is most important. I think we have waited entirely too long to get a clear division of that type of financing.

Furthermore, I am of the opinion that if we are to succeed, particularly with some of these long-range programs such as urban renewal and the development loan funds, things of that kind, we are going to need to resort to the capital investment method, or at least to the borrowing method of financing. I hope you will give it most serious consideration.

Mr. HELLER. We will do that. May Mr. Tobin add a comment on your question?

Senator SPARKMAN. Yes.

Mr. TOBIN. I would just like to distinguish between the accounting that the Government might use for expenditures and the implications for financing of the expenditures.

I certainly think there is a lot to be said for an accounting system which permits distinction between those expenditures that acquire assets for the Government and those that do not. I think you have to think very carefully before you say then that everything in one category should be financed in one way and everything in another category should be financed in another way, that is that, everything of a current nature be financed by taxes and everything of an asset acquiring nature be financed by borrowing.

There may be times when you wanted to use more taxes or less taxes than you have as current expenditures, in connection with the economic situation.

Senator SPARKMAN. I recognize that fact. I would not suggest division. I just happened to use a couple of long-term financing programs as an example. Many others could be given. For instance, there is to be introduced tomorrow, I believe, the educational aid bill. I am of the opinion that some portions of that need to be financed through borrowings.

Many other examples could be picked out. Let me move on to something else very quickly because my time is almost up. That is in the field of housing. You mentioned the drag, the lag, in housing at the present time, and you state that in 1958–59 part of the recovery was due to the fast moving program of home construction. You realize, do you not, that early in 1958 we enacted an emergency housing bill that gave a stimulus to home building? Do you not think that had a lot to do with it?

Mr. HELLER. It surely did. I wonder whether on this question I could refer to Mr. Gordon, who is working particularly in this field. I am sure he would like to comment.

Senator SPARKMAN. Fine.

Mr. GORDON. I would certainly agree, Senator. I think that the 1958 housing bill did, in fact, have a considerable impact on the recovery of housing in that period. I might say that our principal concern, up to this point, has been in the area of private housing credit.

We have been struck with what we consider to be a quite inflexible interest rate situation with respect to mortgage lending rates. As you know, a number of steps have been taken to try to achieve a more rapid reduction in the rates at which private lenders will lend on mortgages than has been the case.

These rates have been very sticky. We say in the report, in the statement, that, in our view, mortgage rates of six and seven percent, and in some areas even higher than that, seem to us to be out of touch with the realities of the underlying economic situation in 1961.

Senator SPARKMAN. I agree with you completely in that. I hope something can be done about it. But I want to suggest to you another area in which I think a great deal of attention ought to be given.

By the way, going back to the 1958 Emegrency Housing Act, you will remember it was made applicable to houses costing not more than $13,500. Last year, if I remember correctly, the typical three-bedroom house built in this country cost $15,000.

In order to be able to buy that kind of a house, a person must have an income of $6,000 or more. If I recall the figures correctly, only 25 percent of the people in this country have salaries like that. In other words, 75 percent of our people are priced out of the market.

I hope you will turn your attention toward striving for more reasonably priced housing that the American people can afford to buy.

Mr. GORDON. There is, as you know, Senator, a Presidential housing message which is currently being prepared, and which I think will shortly be submitted to the Congress. In addition, as we mentioned in this statement, housing is certainly one of the areas that will deserve a most careful look at the time of the April reappraisal of the state of the economy.

Senator SPARKMAN. Thank you, Mr. Chairman.

Chairman PATMAN. Representative Boggs?

Representative BOGGS. Mr. Chairman, I should like to join with the others who have expressed appreciation for this report.

Would you be prepared to characterize this report? Would you call it cautious, optimistic, pessimistic? What would you call it?

Mr. HELLER. I would call it realistic.

Representative BOGGS. Would that be realistic optimism or realistic pessimism?

Mr. HELLER. Well, let us put it as realistic pessimism as we look at the current situation, and realistic optimism as we look at the longer run future of this economy.

Representative BOGGS. How do you account for the present activity in the New York Stock Exchange?

Mr. HELLER. Well, I have not been following that as closely since January 20 as I did before. At least, let us say, not as personally. However, we have been examining the response of the stock market, both to short- and long-run factors, and we have looked back at the previous performance of the stock market as a leading indicator.

That is to say, what has the stock market done in terms of telegraphing the punches, let us say, in terms of telegraphing an upturn? The record reads as follows: In the 1948–49 recession, the stock market turned up 4 months before the upturn in the economy as a whole. In the 1953–54 recession it turned up 10 months before the upturn in the economy as a whole, and again in 1957–58 it turned up 4 months ahead. This time is turned up in October. That is 5 months ago.

There is some question as to whether it is, in effect, discounting an upturn that might be coming. When we are on our optimistic side, Mr. Boggs, we hope that it is telegraphing a punch, but on the other hand, in 1953–54 the upturn occurred 10 months before the upturn in the economy as a whole.

Our feeling is that there must be some prospect of economic improvement in the minds of the people who are buying or we would not have that much of an upturn. But it is not a wholly reliable and carefully timed kind of indicator of where the economy is going.

Representative BOGGS. I have just one other question.

You are not prepared to make specific tax recommendations even in the field of so-called business incentive taxes, are you?

Mr. HELLER. That is not our primary responsibility. That is the primary responsibility of the Treasury Department.

Representative BOGGS. Do you feel, in light of conditions as you have outlined them in your report, that these tax recommendations should be in the line of business incentive taxes which would increase investments and I presume increase production, or in the field of consumer incentive taxes which would pick up slack consumption?

Mr. HELLER. Well, the program as a whole, the program for recovery, has to combine these two measures. The present program already, in terms of unemployment compensation, the social security amendments, and the other Presidential programs, would give a substantial stimulus to the consumer side.

If that stimulus turns out to be insufficient, and the performance of the economy continues to be unsatisfactory and disappointing, then the President has suggested that a new look would be taken in April and there might be additional stimulative measures taken.

But side by side with that, both for the short-run stimulus of investment and for putting us on a higher growth track, we feel that some direct stimulus to the investment side has a lot of attraction.

Representative BOGGS. Thank you, Dr. Heller.

Thank you, Mr. Chairman.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I, too, would like to join in the general chorus, at least on this side of the chairman, in congratulating you on what I think is an excellent and very useful and very intelligent report.

Mr. HELLER. Thank you.

Senator PROXMIRE. I would like to correct you, Mr. Heller, in your statement to the committee that I had said that economic policy is like phrenology. I said economic prediction. I was referring particularly to short-range prediction on the basis of what I have seen seems to be in a guessing or a "guesstimating" stage.

I am particularly conscious of the Time magazine article on you which listed the predictions of a number of economists, some of whom thought we were going up in 6 months, some in 10 months, some of whom thought we were going down. I am sure some of them will be right.

Mr. HELLER. I accept the correction of the statement. I am happy for that restriction of the analogy.

Senator PROXMIRE. While I concur in the hearty approval of this report, especially on the basis of the standards of past reports, I am wondering if it might not be more useful if there could be less emphasis on the short-range future, and what we can do about the current recession, or what is going to happen in the next few months, and more on the realy long-range permanent problems that have to be met.

I would like to ask you a question on the basis of George Shea's column on the front page of the Wall Street Journal this morning which you may or may not have seen.

Mr. HELLER. I have not.

Senator PROXMIRE. What Mr. Shea has done has been to take three recessions, 1948–49, 1953–54, and 1957–58, and then to take the Government's cash budget and to point out that in the 1948–49, recession, which began in November of 1948 and reached the bottom in October of 1949, it was preceded by Government surpluses up until the recession began.

You might say that on the basis of this, the surpluses might have contributed to that recession. On the other hand, in 1953–54, the precise opposite developed. That recession, beginning in July 1953 and bottoming out in April 1954, was preceded by Government deficits, and rather sharp Government deficits.

As we came out of the recession, surpluses began to develop. In other words, the Government's cash position, it would seem, should be, and apparently was, to some extent slowing down recovery from the recession. But the impact of Government was apparently too feeble to have a significant, positive effect.

Then in 1957–58, the recession began in August of 1957 and ended out in April of 1958. He points out there that beginning with the fourth quarter of 1956 and ending with the first 3 months of 1958—there was a break even in the Government cash surplus, cash budget, rather. On the basis of this, of course, there is no way of comparing one way or another.

I think this is a pretty good analysis. It suggests the empirical feebleness of Government fiscal policy. I ask your comment on it.

Mr. HELLER. Let me make a couple of comments in response to that, Senator. I think in this connection it might be useful to have in front of us chart 7, which follows page 38 of my statement.

If we look at the Federal Government's receipts and expenditures on the national income accounts basis, which is the accrued basis—the main difference between that and both the cash consolidated and the regular budget account is that corporate taxes are here handled when they accrue, not when the cash is paid into the Government—we find a much closer correlation at least since 1953 between recession and boom, recession and recovery, and deficits and surpluses, that Mr. Shea may be suggesting in his column.

I have not seen the column. But as you will note, in 1953–54, as the recession developed, an offsetting deficit developed. In the boom of 1955–57, a surplus of substantial proportion developed.

Senator PROXMIRE. May I interrupt to say that in 1953–54, the point Mr. Shea makes, which is correct, I think, is that the recession was preceded by a very substantial deficit, and, therefore, as you moved into the recession, obviously the Government was acting in a contracyclical way that should have been helpful and if Government can be effective, should have kept us out of it.

Mr. HELLER. Mr. Tobin wanted to make a point on military contracts.

Mr. TOBIN. Sometimes the effect of cash transactions of the Government occur prior to the cash transactions. Military contracting is an example of that, where the contracts are let, and the effect on the private economy may occur, considerably before disbursement by the Government.

At the time of the 1953–54 recession, as you know, there was a curtailment of military contracting which preceded the curtailment of the cash payments of the public. That might explain some of the apparent paradox in those figures.

Mr. HELLER. Indeed, there are substantial limitations in some of our measures of the total impact of Government operations on the economy. The stimulative impact, as we suggested in our statement, often precedes the reflection of the Government action in the budget.

Although the Government is not running a deficit, the Government action stimulates the private contractors, in effect, to run a deficit. They borrow money to gather together materials and build equipment and get manpower in anticipation of the work that will then later be reflected in the Government budgets.

I think Mr. Tobin's point is that in military contracting there was a lot of cancellation and cutback by more than 50 percent, in the military contracting at that time, the impact of which was not reflected until later on. I think this has to be taken into account.

I am not trying to say that any one measure will give us all of the Government impacts. I think we have to look at the cash consolidated budget for the actual cash flow, income, and product account budget for the relationship to gross national product, and its development, and some measure of contracts let and so forth, which, thus far, has been impossible to develop.

Senator PROXMIRE. Thank you, Mr. Chairman.

Chairman PATMAN. Without objection, all members will be allowed to extend their remarks in this record today, and include therein extraneous matter, and particularly the questions submitted to the Council and answered by them, before the transcript is corrected.

Mr. Reuss, of Wisconsin.

Representative REUSS. Thank you, Mr. Chairman.

This is a most elegant report, Dr. Heller and colleagues. I am very delighted by it.

Some of us have been unhappy in recent years at what we thought was the failure of the Council to use the full powers under the Employment Act of 1946 to inform Congress and the public as completely as we thought desirable.

Specifically, we regretted that the opportunity given in the act to file supplementary reports after January 20 never seemed to be used. We regretted that the reports rather pointedly left out recommendations on monetary and credit policy, and, finally, we were somewhat unhappy at the failure to state quantitative goals and targets for employment and production.

Thus it is very pleasant to see that in your report you have apparently taken a view more in accord with this interpretation of the Employment Act. You have given us a report on March 6, which is in the nature of a supplementary, post-January 20 report.

You have devoted five pages of the report to monetary policy and debt management, with some recommendations for the future, and you have stated, or at least come close to stating, quantitative goals for employment and production.

I commend the Council for what it has done. I hope that I am right in thinking that this represents a policy for the future; that whenever, for example, you feel supplements should be issued, you intend to do so, and similarly, that on monetary policy you will follow the policy set here this morning.

Mr. HELLER. We view this submission this morning as at least setting some precedents for this Council.

Representative REUSS. Thank you. I would like to ask a question on the balance of payments which you might want to subcontract to one of your colleagues.

I read the section with a great deal of interest, and I would like to ask whether it is the view of the Council that we should try to eliminate the hard core of our payments imbalance, which I think the President in his balance-of-payments message tabbed as around a billion and a half a year. Should it be an objective of our national policy to achieve a balance, perhaps not every year but over a period of years?

Mr. HELLER. As you suggest, this is a question that I will subcontract to Mr. Tobin.

Mr. TOBIN. It is the view which the President expressed in his balance of payments message, that the objective of policy should be a balance in our basic accounts, which would be a combination of current account and the long-term capital account, speaking roughly, and also including the Government's transactions.

That would require, as you know, a surplus in the export-import account, itself. This does not mean a balance every year. We have to expect that different economic conditions in different countries—in our export markets and the countries from which we import—will make deficits here in some years and surpluses here in other years, with correspondingly opposite surpluses and deficits in those countries.

But it does mean that, on the average, we do not think we can continue providing the rest of the world with reserves by a long-range balance of payments deficit.

Representative REUSS. While I appreciate the analysis in the balance of payments section of your report, I am not sure that it quite leads us out of the woods.

You apparently do not foresee a large rise in exports. You state that with recovery in the economy here, imports will increase but that this may be offset by more foreign investment in the United States. Do I understand you to state that you do not really envisage a rectification of our payments imbalance within the current calendar year?

Mr. TOBIN. I do not think we can get out of the woods without trying to get out of the woods. So we have to devote our efforts and policies toward the promotion of exports and toward the rectification of the payments balance. We do not think that just the events in the rest of the world and in our economy unaided will put us back into balance unless we are working hard to make ourselves competitive.

Representative REUSS. One final, quick question.

Can you think of a better way of attaining what we want than by expanding our exports? Can you think of any better, single way than that?

Mr. TOBIN. No: that is what we need to do.

Representative REUSS. That is the best, single way; is it not?

Mr. TOBIN. Yes.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Pell?

Senator PELL. Dr. Heller, I have one question only, and it is a fairly elementary one, I guess. I am puzzled because in Western Europe today, north of the Pyrenees and the Alps, there is no unemployment, and even in the countries in Europe behind the Iron Curtain, there is little unemployment.

Yet in our own country, looking at your figures and graphs here, we see that even in good times there is an element of unemployment in the United States.

I was wondering if you felt that this element of unemployment was endemic to our system or whether there were ways of solving it, economically.

Mr. HELLER. Senator, as what we call our high employment or full employment goal of 4-percent unemployment suggests, we feel that there is a certain level which may not be the irreducible minimum—below which we probably cannot push unemployment within this country without running into very substantial inflationary pressures, bottlenecks in various fields, and an excess of demand. Indeed, the history of our postwar period, while not conclusively proving this, seems to suggest that the 4-percent rate of unemployment has been approximately the point at which we strike a balance between a high level of output and reasonable price stability.

Part of the difference, certainly, between the Western European economies and ours is simply one of size. That is to say, we have an economy in which the adjustments, the questions of immobility, and so forth, are a good deal more serious.

There are some differences, also, in the definition of unemployment, the details of which I am not familiar with, but I have been assured that there are some differences in the definition of unemployment which account for some of the sharp differences in unemployment rates.

As you say, in some of these countries there is virtually no unemployment and in some there is even overemployment. Further, in the Western European countries they are in the midst of a very large capital expansion boom. Their rates of growth are triple our rates of growth.

For example, in Germany and Italy the rate of growth is above 5 percent, as against our actual rate of growth of 2.5 percent. Under these circumstances, with strongly expansionary activity in their economies, they absorb all of the manpower available to them.

Senator PELL. Pursuing this thought for one further second, do you believe that we should accept the 4 percent unemployment rate as being the accepted state of things in our economy, or can we shoot for a zero rate as it is in these other countries?

Mr. HELLER. I think this: that as we state in the report, the 4 percent is a conservative estimate of where our full employment potential lies. However, I do not feel any possibility, without raging inflation, of getting our unemployment down to zero.

Senator PELL. But there is little inflation in Germany or France or Britain.

Mr. HELLER. There is a considerable amount of inflation at the present time; that is, their price levels are rising faster than ours and Germany's wage rates, for example, rose on the average by 9 percent this past year.

Senator PELL. Did the cost of living go up proportionately?

Mr. HELLER. The cost of living has been going up rather steadily, although not as much as the 9 percent. Mr. Tobin would like to comment on this, as well.

Mr. TOBIN. I just wanted to add that you, Senator, carefully defined the areas we are talking about as above the Pyrenees and the Alps. Of course, in Italy we know there is a large amount of unemployment, and a surplus of labor, which also helps the countries in the rest of Europe, because from time to time they use the Italian labor surplus to draw in additional manpower when they need it.

Also, Germany has been aided by another source of manpower, which contributes to a fairly tight-running economy with a low unemployment rate, namely, the refugees from the East. Both of these things might make the contrast a little less sharp than you make it.

Senator DOUGLAS. (presiding). Mrs. Griffiths, we are glad to have you here.

Representative GRIFFITHS. Thank you, Mr. Chairman.

After saying that I did very much enjoy your analysis, I would like to ask you, Dr. Heller, as regarding the composition of unemployment that you have referred to on page 15, a recent financial analysist pointed out that the largest unemployment was in those industries that were paying the highest wage rates, that is, steel, autos, and three others.

First, I would like to ask you if this is true, and secondly, do you agree with his implication that these industries have priced themselves out of the market?

Mr. HELLER. I would say that generally speaking the rates of unemployment in those industries—I believe he cited coal, steel and automobiles—the rates of unemployment in those industries have been rather high.

Unquestionably, the process of modernization and automation of machinery, improvements of productive methods, and so forth, has caused a problem of considerable employment adjustment. It may be that even for full capacity operations those industries do not, any longer, need the labor force that is still attached to, say, the steelmaking communities, and that there will have to be either supplementation of the industrial base of some of those areas or a transfer of some of the unemployed to other areas. Retraining and mobility, of course, are important factors.

Mr. Tobin may want to comment further on these unemployment figures.

Mr. TOBIN. The general tenor of our analysis of unemployment as it has changed since earlier periods is that the increase has been quite pervasive. It has increased in all industries, in all occupations, all groups of the population, let us say, from 1957 to 1960.

Some industries have had a greater unemployment problem than others, but that is not a new phenomenon.

Representative GRIFFITHS. Thank you.

Mr. HELLER. May I ask also Mr. Gordon to comment on your question?

Representative GRIFFITHS. Yes.

Mr. GORDON. We have, as a matter of fact, Mrs. Griffiths, a table which summarizes the relationship between rates of wages and percentage of unemployment currently. I am afraid I do not have it here. I would be happy to submit it for the record.

I think it is a fair summary of this brief analysis to say that there does not seem to be a very close correlation, and that there are low-wage industries with high rates of unemployment and there are higher wage industries with relatively low rates of unemployment, looking across the whole structure.

(The following was subsequently received for the record:)

Rank correlation of average hourly earnings and unemployment rates in 21 industries for which data are available

Industries ranked by average hourly earnings	Average hourly earnings in 1960	Rate of unemployment in 1960	Rank by unemployment rate
1. Contract construction	$3.28	12.2	1
2. Primary metals	2.83	7.8	7
3. Motor vehicles and equipment	2.81	8.4	5
4. Printing and publishing	2.77	3.6	19
5. Mining	2.70	9.5	3
6. Railroads	2.60	5.2	15
7. Machinery, excluding electric	2.57	4.7	18
8. Chemicals	2.51	3.3	20
9. Communications and other utilities	[1] 2.46	2.7	21
10. Fabricated metals	2.45	6.1	13
11. Electrical machinery	2.30	5.0	16
12. Wholesale trade	2.30	4.9	17
13. Stone, clay, and glass	2.28	6.0	14
14. Food products	2.18	6.4	10
15. Lumber and wood products	2.03	9.1	4
16. Furniture and fixtures	1.86	6.9	9
17. Retail trade	1.81	6.2	12
18. Textile mill products	1.62	6.3	11
19. Apparel and finished textile products	1.56	10.5	2
20. Personal services	[2] 1.26	7.0	8
21. Agriculture	.82	8.0	6
Coefficient of rank correlation	−.121		
Standard error of the coefficient	.224		

[1] Weighted average of telephone, telegraph, and gas and electric utilities.
[2] Weighted average of hotels, laundries, cleaning and dyeing establishments.

Source: Departments of Labor and Agriculture.

Representative GRIFFITHS. May I ask you: Is there a faster shift to automation in a high-wage industry than in a low-wage industry, or do you know?

Mr. GORDON. I am reluctant to answer that off the top of my head. I have an impulse to give an answer, but I would rather look at the facts.

Representative GRIFFITHS. Thank you. Then I would like to ask about another subject. I asked on three occasions, I think, if the person being questioned, who was a representative of American industry, would consider that an industry doing business in a developing country were entitled to share the risks of inflation and confiscation with the American taxpayer.

No one seemed to have any idea. Yesterday I observed that those who are going to pay the taxes would now like to write off their Cuban losses against their American income. I presume that this is not possible, and I do not ask you to be specific on what you think could or should be done, but may I ask what factors you would consider before determining that some measure of relief should be given to those people doing business in developing countries?

Mr. HELLER. May I make one comment on the loss observation that you made, and that is that losses of that kind are, of course, deductible from taxable income and can be carried forward over a period of years so that there is at least to that extent a sharing in the losses.

Let us say it is a corporation that sustains those losses. In effect, the Federal Government, through the 52 percent corporation income-tax rate, does share in the losses, even as it shares in the gains through the tax on profitable operations.

The question you raise, however, is a very broad one in the whole field of our foreign economic policy, which relates both to our programs for development of underdeveloped countries, where you might give one answer, and to our investments in some of the strong countries of the world, where one might give another. There the chance of expropriation and confiscation is a good deal less, of course.

Representative GRIFFITHS. I was applying it only to the underdeveloped countries, not to the developed ones.

Mr. HELLER. As I say, it is in the context of that general economic policy that we would want to consider this question. Perhaps Mr. Tobin would want to comment further.

Mr. TOBIN. I think it may be appropriately in line with national policy to stimulate private investment in those areas, to consider certain special risks which attach to those investments—not only the expropriation problem which you mentioned, but also the possibility of exchange rate changes or blocking of funds which might make it difficult for the investors to return the dollars.

These are risks which normally do not attach to investments within the United States. Some method of pooling or sharing these risks might well be considered.

Representative GRIFFITHS. Thank you, Mr. Chairman.

Senator DOUGLAS. I would suggest that on this next go-around we restrict ourselves to not more than 7 minutes. Mr. Curtis?

Representative CURTIS. Mr. Chairman, I have pointed out that with the permission we have to submit questions, rather than to attempt to skim the surface, I think it would be much better if we prepared those questions and went at it at that time. Thank you.

Senator DOUGLAS. Mr. Heller, I understood Mr. Samuelson to say last night on "Meet the Press" that he estimated the cost of the President's program at $5 billion. I notice that you made the estimate of $3 billion.

Could you account for the difference between these two estimates?

Mr. HELLER. As we tried to point out in our statement, we are not pricing out the President's programs as a whole. We are taking those on which price tags have already been put and trying to put them on a comparable basis from the standpoint of assessing their impact on the economic situation.

Those on which price tags have been put, if they were all enacted immediately, would release about $3 billion into the income stream in the first 12 months. But this would not be their total cost and does not apply either to the 1961 or 1962 budget as such.

It is a somewhat hypothetical calculation. I do not know where Professor Samuelson gets his $5 billion figure.

Senator PROXMIRE. If the Senator will yield on that point, is it not true that Samuelson included the defense increase? As I understand it, you deliberately excluded that. That could be about $2 billion there.

Mr. HELLER. Thank you for that amendment. We explicitly put in no estimate for defense. I imagine Professor Samuelson did in his appraisal.

Senator DOUGLAS. You speak about a temporary income tax cut if the economy fails to respond satisfactorily. I advocated such a reduction in February 1958. It did not meet with too great enthusiasm at the time.

May I ask what standards you would set up in judging whether or not such an income tax cut would be desirable? What percentage of unemployment would you use as a figure?

Mr. HELLER. Senator Douglas, we have not established in our own minds any particular standard of unemployment. I think one has to examine a whole series of questions, including the unemployment rate, what is happening to industrial production, what happens to profits, gross national product, and so forth.

It has to be based on a reading both of the current situation and of either a substantially improving or only mildly improving or actually deteriorating outlook for the economy.

Senator DOUGLAS. Suppose the unemployment were to continue at a rate of approximately 7 percent.

Mr. HELLER. May I put it this way: That would certainly lead to some serious second thoughts about the problem. But I would not wish to say that it would trigger either in our minds or in the mind of the President a proposal for an income tax cut.

Senator DOUGLAS. If you were to advocate an income tax cut, what form do you think it should take?

Mr. HELLER. Again, I hesitate to respond in specific terms. This is something that would have to be worked out with the Treasury and other Government agencies. I think that every effort should be made to concentrate the punch of the income tax cut in such a way that maximum spending out of proceeds of the cut would be achieved.

Senator DOUGLAS. Would this lead you to a temporary reduction in the withholding tax on incomes?

Mr. HELLER. The reduction of withholding would be the instrument through which you would implement any income tax cuts, so that the cut could go into effect virtually immediately. The Internal Revenue Service is geared to shifting the rate of withholding, as has been demonstrated in several cases in the past, in 1951 and 1950, within just a couple of weeks after the Congress acts.

Senator DOUGLAS. Would you favor a maximum time limit during which the cut would be effective, with the President given discretionary powers to restore the tax in whole or in part if economic conditions in his judgment so recommended?

Mr. HELLER. Well, again, this is a question of overall policy on which many different considerations bear. If one looked at the best of all possible methods, some combination of congressional and executive responsibility which would be able to respond very quickly to economic conditions would seem to be ideal. Just what form that should take, and whether this is the time to introduce it, is a separate question.

Senator DOUGLAS. I will call on Congressman Reuss.

Representative REUSS. I have just one question, and it is not an easy one.

Assuming that all of the measures currently recommended by the President are adopted, what diminution of unemployment would result by, let us say, December of this year?

Mr. HELLER. Again, it would be extremely difficult to give a specific figure on this, Mr. Reuss, because it depends on what happens to the interaction between the Government's program and the natural regenerative forces of the economy.

Here, Senator Proxmire's warning is particularly apt. In other words, whereas one can do something with the foreseeing of trends in the economy, that is changes in direction of movement, it is extremely hard to say just how much power these will pick up at various stages of the game.

We do feel that in this recession the outlook for a fast pickup from the natural forces in the economy is very much less promising than in the preceding recession. Nevertheless, there is no way of forecasting with any assurance how far the interaction of the programs—particularly not knowing the dates of enactment—and the natural forces of the private economy would carry us toward our goals by December.

This is an area where you have to wait and see, be flexible, be prepared to take further action if the situation develops unsatisfactorily.

Representative REUSS. I therefore take it that you and your colleagues do not exclude the possibility that even prompt action by the Congress on the recommendations so far made might, if other factors do not come into play, result in a situation where unemployment is not dramatically reduced by the end of this year from its present unhappy 7-percent level?

Mr. HELLER. As a matter of act, to illustrate the general point you are making, we do in the statement note that even if we got an $18 billion increase in gross national product at stable prices by the fourth quarter of this year, the unemployment situation might not be much improved because of the very large additions to the labor force.

This is a stubborn, persistent problem, not in the sense that the unemployed are unemployable, but that the restoration of the economy to a level of full operation is going to take time.

Representative REUSS Thank you.

Senator DOUGLAS. Senator Sparkman?

Senator SPARKMAN. Doctor, both in your paper and in your replies to Senator Douglas, I take it that if a tax change should come about, it would be for the purpose of spurring the purchase of consumer goods rather than looking toward plant expansion.

Mr. HELLER. In answering a previous question, I suggested, Senator, that we were looking to the possibility, if such a cut were undertaken, of a balanced program in which there would both be the temporary income tax cut and other measures to support consumer spending and, indeed, a form of special incentives for investments which would stimulate plant modernization and expansion.

Senator SPARKMAN. Is it not true that in the 1954 tax cut, primary emphasis was placed on plant expansion?

Mr. HELLER. That is a little hard to answer in a "Yes" or "No" fashion. After all, we had a total——

Senator SPARKMAN. May I change the question a little bit and say in your opinion did the effect of the 1954 tax program—was the effect of that to overexpand, perhaps?

Mr. HELLER. Studies of the impact, particularly of the liberalization of depreciation at that period, are not conclusive on this point. Some of them suggest that by the time it reached its full impact it was stimulating a situation in which there was already a very strong natural force working for high investments. But unfortunately, Senator, some of these experiments cannot take place in the test tube, and it is very hard to isolate the part that accelerated depreciation played during that period.

Senator SPARKMAN. Is it not true that we have had an overabundance of productive capacity for the last several years?

Mr. HELLER. Yes. Because of the inadequacy of the markets.

Senator SPARKMAN. That is, since that program was stimulated?

Mr. HELLER. That is right.

Senator SPARKMAN. Doctor, I want to ask you about this: A part of that tax incentive program looking toward expansion of plants and productive capacity was the provision that permitted rapid depreciation of new equipment.

Our Small Business Committee has been trying ever since to get included in there also the used equipment, since when the bigger businesses dispose of their equipment to put in new equipment, they are going to sell that, in most instances, to smaller businesses that are trying to expand. Why this inequity as between the two types of business? Why can't we get it removed?

Mr. HELLER. I think this would get me outside of my jurisdiction.

Senator SPARKMAN. Well, I will not ask you to answer that question. Will you give that most serious consideration and consider it in making recommendations to the President?

Mr. HELLER. We will be happy to look at it very carefully, Senator.

May I just add to what I was saying earlier, that while we have no test tube experiments by which to determine what the stimulating effect of those liberalization provisions might have been, the fact of the matter is, of course, that accelerated depreciation raises the level of profitability of investment at any given level of output.

It decreases the span of the payoff period. In that sense it reduces the length of time that one has an investment at risk, and if businessmen are rational in their investment decisions it ought to make investment more attractive.

All I am saying is that we do not have any precise way of measuring how this attractiveness affects investment.

Senator SPARKMAN. One other thing, looking toward plant expansion and, again, this is a proposal that the Small Business Committee has unanimously proposed several different times. I think every member of the Small Business Committee has joined in sponsoring a bill in this session of Congress, as it has done, unsuccessfully, I may say, in previous sessions of the Congress, to provide for a plowback in modest amounts, not to exceed 30 percent, or $20,000, whichever is lesser, of the earnings of the company for the purpose of expanding their business, either through equipment, expanding the plant, inventories, and so forth.

Would you care to comment on that, or, if not, will you give that most careful consideration in preparing your recommendations to the President?

Mr. HELLER. Thank you for that alternative. We shall do so.

Senator SPARKMAN. And may I say I think it would be one of the greatest stimuli that we could have if you really want to get business moving. After all, the businesses that are most numerous in this country and that do react quickly are the smaller businesses.

All businesses would profit from this, but it is the smaller businesses that would particularly be able to make use of it.

That is all, Mr. Chairman.

Senator DOUGLAS. Congressman Curtis?

Representative CURTIS. I would add, too, that I hope you will give good advice to the President because this is a bipartisan approach. This originally had the name of the Curtis bill on it, so I am particularly interested.

Senator SPARKMAN. That was on the House side, and I fully agree with you that it certainly did.

Mr. HELLER. May I join this bipartisan consensus at least to the point of saying that the stimulus and invigoration of small business is, of course, an important part of maintaining the competitiveness of our economy and this is certainly given full consideration in our studies of economic policy.

Senator SPARKMAN. By the way, am I correct in my thought for the moment that 50 percent of the employment in this country is in small business? As I recall, that is the figure.

Mr. HELLER. I will turn to Congressman Curtis for the answer to that since I do not have it.

Representative CURTIS. I wish I knew. No; I do not know. It is a very high figure.

Senator SPARKMAN. I think it is 50 percent. I will try to find out.

Representative CURTIS. Here is a misconception on trying to help small business that I find occurs frequently: The bulk of small business does business under the noncorporate form. So often when we talk about small business, we think in terms of the small corporation.

Secondly, the bulk of small business is in the service and distributive fields, not in manufacturing. So often we will talk about helping business and think in terms of manufacturing, forgetting that the distributive and service fields are now almost looming larger in our economy.

I am glad they are because I think it shows a basically more sound and flexible economy. But small business predominates in the field of service and distribution. The key to the Sparkman-Ikard-Curtis bill, as it now is, is that you measure the plowback in growth, economic growth, capital expansion, in one of three ways, or combinations: (1) Depreciable items which, of course, immediately hits the manufacturing concern; and secondly, in inventory.

A distributive business, if it is going to expand its operation, frequently will not be doing it in a depreciable item but will have to expand its inventory. And third, in the retail and other outlets. If you make expansion, it is frequently in accounts receivable.

So this measures in those three different ways or any combination, and, thereby, is the first bill that I know of that has ever really hit at what is the real problem of what the bulk of small business is doing, the unincorporated form and the service and distributive fields.

I was glad to have the opportunity to expound on that.

Senator SPARKMAN. I appreciate the bracing that you gave it.

Mr. Chairman, may I say just this to the Doctor: The President is not entirely unfamiliar with this. He was formerly a member of the Senate Small Business Committee, and only recently I discussed these measures with him.

Senator DOUGLAS. Senator Proxmire?

Senator PROXMIRE. I want to take up what Senator Sparkman spent some time on.

Mr. Heller, you say that you compare 1960 business expenditures with 1956–57, and you say that 1960 expenditures were 9 percent below the levels achieved in 1956–57.

In the first place, isn't that 1956–57 the highest possible base? Was that not an alltime record in business investments and quite strikingly higher than ever before in the history of the country, at least in peacetime or, I guess, any time?

Mr. HELLER. That was our peak investment period; yes.

Senator PROXMIRE. In the second place, is it not true that as long as we have steel operating at 50 percent of capacity, or 60 percent, automobiles at maybe two-thirds or three-quarters, and many other manufacturing industries well below capacity, that it is unrealistic to expect a very great increase in investments for purposes of plant expansion?

You may get it from modernization or improvement in efficiency, but not from plant expansion. Is that not correct?

Mr. HELLER. In that connection, may I return for a moment to the question of the tax incentive for investment that we were speaking about a moment ago? The expansionary investment incentive would have to come largely from markets. It is perfectly true that the gap between production and demand in some industries is much wider than others, and an overall increase in demand would hit some industries more slowly than others.

The modernization incentive, however, is somewhat independent of this, not entirely, but somewhat, and could be affected by the investment incentive in the tax system. Hence, it will be presented to the Congress within the next month or so as a program quite independent of the other measures which are designed to stimulate the economy on the demand side.

This is something that can help both now and later.

Senator PROXMIRE. Now I take up the tax cut to increase demand as distinct from the possible tax changes to increase incentives for investment. You say that with the budget in balance at less than full employment, that is, perhaps at less than 4 percent, that there might be an incentive for cutting taxes. Did I understand you to say that?

Mr. HELLER. What I was saying was that if, on review of the economic situation, economic developments to date appear disappointing, one of the methods that ought to be considered most seriously for a stimulus is a tax cut.

As I said in responding to Senator Douglas, one of the things that would be seriously weighed would be the unemployment rate.

Senator PROXMIRE. Let me point this out. We now have a situation in which many people feel the pent-up demands of World War II have been met and the pent-up demands of the Korean war have been met. We have, as you pointed out so well in your report, a great increase in the labor force. We have automated and technological unemployment.

Under these circumstances, it would seem to me that our most recent historical experience with a similar situation, I do not want to be dismal, was the 1930's. In your judgment, would a reduction in taxes during the 1930's have been as useful in terms of the public interest as the programs of substantial expenditure in which the Government engaged in, and would they have been as effective in eliminating or reducing—I should say reducing—unemployment?

Mr. HELLER. Well, in the 1930's of course, we had a much smaller Government relative to the total economy, and the scope for action was much more limited. As far as the comparison between expenditure increase, particularly on substantive programs, and the tax cut is concerned, it is generally accepted that per dollar of expenditure one gets more stimulative effect on income and employment than one does per dollar of tax cut.

However, the tax cut has the advantage of speed and simplicity as compared with expenditure increases. Moreover, one reaches decisions as to the proper distribution of resources between public and private use in the interest of maximum efficiency, and this also affects the decision as between the tax cut route and the expenditure route.

But I think unquestionably in the period of the 1930's, to take your specific example, the economy would have benefited from a tax cut. At that time, however, we had not yet learned many of the lessons of modern economics.

If you will recall, President Roosevelt came in on a budget-balancing platform and tax increases were enacted in 1933 at the depths of the depression.

Senator PROXMIRE. I am not sure that all of us have learned the lessons of economics that way as yet. I am not sure that I could convince myself, and I doubt very much if I could convince many of my colleagues in the Senate, that as we move into a possible period of unemployment it is wise to reduce Government revenues, particularly if we view that period of unemployment as being of a long-term secular nature. Under those circumstances we would be digging a deeper and deeper fiscal hole, and taking an irresponsible fiscal policy because we would be assuming that some day we are going to move into a period of boom when we can recover the expenditures that we made in the depression period. This might never develop.

Mr. HELLER. This is why in discussing the possible second-stage measures we are talking in terms of a temporary tax cut, so that when we return to fuller employment conditions, the power of the tax system could be used for the programs that are required in the Government sector, could be used for debt retirement which, in turn, will enable us to maintain lower interest rates.

Senator PROXMIRE. This is exactly why I object to the notion of a temporary tax cut, because I think it is going to be tremendously hard to keep temporary. It will, unless we can work out some other solution to our technological unemployment and to the increase in the labor force. On the basis of our most recent peacetime historical experience which had 16, 17, to 25 percent of the work force out of work, a temporary tax cut is going to result in a series of temporary tax cuts which become permanent, an alternative which most of us, rightly or wrongly, are not going to be willing to buy.

Mr. HELLER. I think there are two comments to make, and then I would like to turn the floor over to Mr. Tobin, who will comment further.

I think it is yet to be seen whether we are in a chronic underemployment or unemployment situation. We are not willing to accept this rather dismal outlook. We feel that the economy can, in the course of time, be brought to a satisfactory level of full employment and be put back on the track.

Senator PROXMIRE. I hesitate again to interrupt you, but I say that your appendix B, it seems to me, knocks down one of the fondest hopes that I have, that we can, in a sense, educate ourselves out of this kind of a situation by training more skilled people and technicians and professional people. Glancing at it, it would seem that this is not a very feasible or practical solution.

Mr. HELLER. Let me refer that question to Mr. Tobin, because we do not feel that that is what supplement B says.

Senator PROXMIRE. I am glad if it does not. I have not had a chance to read it all the way.

Mr. HELLER. I would like him to comment on it.

Mr. TOBIN. I think what supplement B says is that the problem of excessive unemployment that we have now is not a matter of the structure of the labor force or technological unemployment. It is a problem that is amenable to remedy by stimulating aggregate demand.

So it is not a hard core of unemployment which will not yield if we take the fiscal and monetary measures that will get the economy back to a high level of demand. Of course, we are interested in programs of education and retraining of workers to match the expected demands for people of different occupations and skills in the future. But that is not the main part, far from it, of any program to reduce the present level of unemployment.

That is a fortunate thing, I think, because it would be much more difficult to deal with the present unemployment if it were a matter of some kind of fundamental change in the system and in the matching of the labor force to the system than if it is a matter of insufficiency of demand, which it seems to be.

For that reason, we would not accept the idea what we have a chronic or growing longrun problem of unemployment but, rather, that we have a problem of unemployment that we can defeat by fairly standard fiscal and monetary means provided these are applied resolutely enough.

Mr. HELLER. May I add, Senator, that this is by no means a suggestion that education and training and so forth do not make a big contribution.

Senator PROXMIRE. I am sure they do.

Mr. HELLER. But they make a contribution more in the context of economic growth. If you take a man that would have been, let us say, a skilled worker or a medical technician and give him an opportunity to become a doctor, he obviously will contribute more to the country's product and wealth than if he had remained in his less trained status.

So this investment in human beings is an extremely important component of economic growth and needs to be stressed for that reason.

Mr. TOBIN. Could I add that technological change is nothing new to the American economy and neither is growth in the labor force. The economy over a long period of time has successfully absorbed new entrants in the labor force and has successfully absorbed into new jobs the numbers of people who have been displaced from other jobs by technological change.

There is no reason to think that the economy cannot continue to do that. Those adjustments, in fact, are easier for the economy to accomplish when it is operating at a high level of demand than when it is operating under recession conditions.

Senator PROXMIRE. I would just reply and then I have one more quick question, that the fact is that we have had very serious unemployment in our economic history, very serious unemployment, that I think would now be unacceptable to most of us. We have had a series of wars every generation, virtually. War is, we hope, something that—for various reasons of the balance of terror, and so forth—we may not have for some time, we hope and pray.

But under these circumstances, it seems to me that we have a far different and tremendously serious problem of solving this economic situation than we have ever had before. It seems to me that recurring to an economic history which is quite different, because we have had serious depressions, we have had unemployment for long periods, we have had wars, just is not satisfactory and we have to press farther in our investigation and in our analysis and come up with something that I have not seen so far, which would solve this problem on a more permanent basis.

The only other quick question I have is: Does your cost include the reduction in the farm program which Secretary Freeman told our Committee on Agriculture, a 1-year crash program, resulting in a billion-dollar reduction in the cost of the farm program.

He said his proposal on feed grains and corn would cut the cost of that program by about a billion dollars. Do you include that in your analysis?

Mr. HELLER. No; it is not included.

Senator PROXMIRE. The effect of this 1-year program is not during the current budget year, but over a longer period?

Mr. HELLER. Our figures concern the thrust of these programs over the first 12 months after enactment and do not refer to any particular budget year.

Senator PROXMIRE. Thank you.

Mr. HELLER. May I just add, Senator, that we hope that in our approach to this analysis we will not be doctrinaire. We do not assume that we have all the answers. We assume that many of these answers will become more apparent only as we see what shape the economy takes in the next months and years.

Senator DOUGLAS. Senator Pell?

Senator PELL. I have no questions.

Senator DOUGLAS. Thank you very much, gentlemen, for very good testimony.

The meeting which was scheduled for this afternoon will not take place. It has been postponed.

The committee will meet tomorrow morning at 10 o'clock in the Old Supreme Court, the Capitol, and Mr. Dillon, Secretary of the Treasury, will testify at that time.

(Whereupon, at 12:40 p.m., the joint committee recessed, to reconvene at 10 a.m., Tuesday, March 7, 1961.)

JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

TUESDAY, MARCH 7, 1961

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

The committee met at 10 a.m., pursuant to recess, in room P–63, the Capitol, Representative Wright Patman (chairman) presiding.

Present: Representatives Patman, Bolling, Boggs, Reuss, Griffiths, Curtis, and Kilburn; Senators Douglas, Sparkman, Proxmire, Pell, Bush, and Javits.

Also present: William Summers Johnson, executive director; John W. Lehman, deputy director and chief clerk.

Chairman PATMAN. The committee will please come to order.

This morning we will hear from Mr. Douglas Dillon, Secretary of the Treasury.

Before calling on Mr. Dillon, I want to again list the changes in the announced schedule. The Chairman of the Board of Governors of the Federal Reserve System will be heard this afternoon at 2:30 instead of 2:00, here in this room.

The Assistant Secretary of Defense, Mr. Charles Hitch, will not be heard tomorrow morning, since his appearance and the appearance of the Director of the Bureau of the Budget, David Bell, have been postponed until later in the month.

Mr. Dillon, we are delighted to have you with us. You may proceed in your own way, sir.

STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY, ACCOMPANIED BY HENRY H. FOWLER, UNDER SECRETARY OF THE TREASURY; ROBERT ROOSA, UNDER SECRETARY FOR MONETARY AFFAIRS; AND JOSEPH BARR, SPECIAL ASSISTANT FOR CONGRESSIONAL RELATIONS

Secretary DILLON. Mr. Chairman, I have with me in the room today Under Secretary Fowler and Under Secretary Roosa, as well as Mr. Barr.

Chairman PATMAN. We are glad to have them.

Secretary DILLON. Mr. Chairman, I am pleased to meet today with this distinguished committee. It is important that we discuss the broad outlines of our economic situation and the economic programs the Government should follow in pursuit of our central national objective.

This objective, simply stated, is to preserve and develop the security, freedom, and prosperity of the United States within a strong, free world. Our economic policies, both domestic and foreign, can be used effectively to serve our central objective if they are directed particularly at three specific economic objectives which have been a subject of particular concern to this committee during the past year.

The first national economic objective is that stated in the Employment Act of 1946; namely, the maintenance of a high level of employment or, in the words of the act, "maximum employment."

During the intervening years, marked at various times by unanticipated price rises, attention shifted to the problem of inflation and reasonable price stability emerged as a second national economic objective.

More recently, a third national objective has received increasing emphasis—to develop economic policies directed at stimulating maximum sustainable rates of growth within our own country and within the economies of our friends and allies.

In pursuing these national economic objectives it is important to keep in mind other national objectives such as national security, a desirable degree of economic freedom, a maintenance of a market mechanism unimpaired by the absence of workable competition, the provision of adequate Government services in areas where private action will not suffice, and some equitable distribution of income and opportunity.

It is only realistic to recognize that some courses of policy and action can serve to promote the achievement of certain of our goals at the sacrifice of others. It seems important that we search for and employ those economic policies which are best designed to achieve a maximum of all of these desirable objectives, without unduly sacrificing one at the expense of another.

In moving now, in the year 1961, toward these long-range national economic objectives, we must recognize the urgency of the two major problems immediately confronting us:

First, the problem of bringing about a prompt recovery from the present recession and, even more important, a continuing, vigorous expansion in our domestic economy.

Second, curing the long-standing imbalance in our international payments, and working in concert with other industrialized nations toward a more permanent equilibrium.

The simultaneous occurrence of recession and acute balance of payments difficulties posed new and complex problems for the United States last year. The sensitive interrelationship between our domestic economy and our balance of payments situation can be expected to remain with us in the future.

For today, we face an international economic situation quite different from anything we have seen for over 30 years. This new situation arose 2 years ago with the return of convertibility in Europe. For the first time since the 1930's all the major currencies of the free world became freely interchangeable for current transactions.

This new situation severely aggravated our balance of payments problem last year and, in turn, it determined the nature of some of our responses to recession here at home.

To begin with, I should like to review briefly the significant developments in our balance of payments in recent years.

Between 1951 and 1957, foreign countries utilized the proceeds of their surpluses, averaging roughly $1 billion a year, to build up needed reserves of dollars. The situation has been quite different since 1957. In 1958 and 1959 our exports fell off sharply and our imports rose.

Our deficit rose to $3½ billion and more a year and we had to pay out some $3 billion in gold to cover a large part of this deficit. In 1960 another overall deficit of $3.8 billion occurred and we paid out another $1.7 billion of gold.

The situation in 1960 was dominated by a new element. Our exports had a very good year. But a very large outflow of short-term capital took place, mainly from June to the end of the year. Our basic deficit—that is, minus the short-term capital outflow—markedly improved, and was estimated at about $1½ billion, as against something over $4 billion in 1959.

The outflow of short-term capital, amounting to more than $2 billion, was the major factor in the large drain of gold and dollars during the final 6 months of last year.

Now, what caused this new phenomenon—the large-scale exodus of short-term capital?

With convertibility, international money markets have again become closely interconnected and liquid funds now flow freely in large volume between these markets in response to differentials in interest rates, as well as to speculative considerations. When recession here coincided with boom abroad from mid-1960 onward, monetary policies and interest rates in the United States and Europe diverged widely.

At one time last fall, a short-term investor could obtain as much as 2 percent more on his money in London than in New York. Hence, a broad stream of short-term capital moved from New York to London and other European money centers in search of these higher short-term rates.

The size of this flow shook confidence in our ability to maintain the value of the dollar. Speculation began against the dollar and added to the outflow. This speculative fever continued unabated until late January.

The first task of this administration was to restore confidence and put an end to these speculative movements. The President promptly pledged that the official dollar price of gold would be maintained at $35 per ounce. He also outlined a broad and comprehensive approach to achieving an overall equilibrium in our international payments, placing heavy emphasis on expanding our exports. He rejected protectionism as ineffective and undesirable and stressed that help for the less-developed countries from all the economically advanced countries must be enlarged.

I am pleased to report that reaction abroad to the President's vigorous and determined approach has been very favorable. The dollar once again is strong. There has been a decided slackening in the outflow of gold and dollars and there are signs that some of the speculative funds that left our shores last fall are beginning to return.

This is not, of course, a sign that the problem is over, but only that the world believes that we mean what we say. It is imperative, therefore, that we press on with more fundamental measures for correcting our basis balance-of-payments deficit, utilizing the breathing spell provided by this free world vote of confidence.

It is clear that achievement of reasonable equilibrium in our balance of payments will not be a simple task. It will involve vigorous and many-sided action by our Government, the cooperation of other free countries, and active and enlightened support by our own people. I am increasingly hopeful that if we utilize these elements, properly welded together, we can reach our goal within the next 2 years.

One inescapable conclusion which emerged from the short-term capital movements of 1960 is the need for more effective international cooperation in economic and monetary policy in order to minimize the disruptive effects, and the magnitude of such movements. To be sure, there will always be differences among countries in the timing of booms and recessions, and there will always be some need for a short-term capital flow.

But if fuller exchanges of views and experience among the financial officials of leading countries can in any way reduce the impact of these swings, we must seek such exchanges. We hope to pursue this cooperation through the proposed new Organization for Economic Cooperation and Development—OECD—through the International Monetary Fund, and in other appropriate ways.

At longer range, we are instituting a thorough exploration of measures to improve the functioning of the International Monetary Fund and to strengthen its capabilities, in order to assure adequate and flexible liquidity for the growth that lies ahead.

I have said that we must utilize the time given us by the restoration of confidence to attack the problem of our basic deficit, which last year amounted to about $1.5 billion. In dealing with this basic deficit, we are actively pursuing the specific lines of policy laid down by the President.

For example, we expect to tie our military procurement and economic aid expenditures even more closely to U.S. sources of supply. We are preparing to improve our facilities for providing credit to our exporters. We are moving vigorously to promote an increased stream of tourists to the United States.

We are recommending a reduction in tourist allowances. We are developing procedures to encourage foreign monetary authorities to hold dollars. And we are reexamining the tax status of American investment abroad to determine whether it is paying its fair share of our national tax and whether or not any deficiency of our tax system in this regard has contributed substantially to an imbalance of payments.

We will continue to explore ways and means of assuring that the substantial payment imbalances of recent years are not continued so as to impair our national economic position.

But improvement in our basic deficit also means that the chronic surplus in the balance of payments of certain other advanced countries needs to be simultaneously reduced. This calls for improved international cooperation across the broad spectrum of economic policies. International cooperation is also increasingly needed in approaching what are now mutual responsibilities for a rising flow of capital to the less-developed countries. We hope to facilitate both of these types of cooperation through the OECD.

It is also essential for our people to realize that we are inevitably subject to international competition. Just as this country has always found open competition to be a major force in stimulating growth, expansion, and technological change here at home, the same is proving to be true internationally. This development serves to emphasize our need to remain strong and competitive—and not restrictive or isolated.

Obviously, this has a great many implications for American industry in terms of the price-wage-cost structure. It becomes important to emphasize to both management and labor that profits and wages need not always be increased to provide more benefits to investors and workers. Both of these economic groups are made up of individual consumers.

Hence, the provision of more goods and services for the same dollar by some lowering of prices with increasing productivity may better distribute the benefits of that increased productivity between workers, investors, and consumers, without sacrificing our international competitive position.

The President has just provided a channel for funneling many of these considerations and bringing them to bear on key problems through the President's Advisory Committee on Labor-Management Policy.

Now to return to the problems of our economy here at home. We must try to produce an environment that will not only bring us out of our present recession, but will also permit our economy to grow at a faster rate than has been the case in recent years.

The role of the Federal Government as an energizing force in the growth of our economy and as a stabilizing influence upon its ups and downs is daily becoming more important. But there are limits upon what the Government can or should do. It is as important to avoid overcommitment as undercommitment, as essential to avoid waste as to avoid constrictive economy. We must make certain that the powerful and productive influence of the Federal Government is used most effectively.

Our Nation's resources—the capacity of our people and the quality of our physical plant and materials—are impressive. But they are not presently being fully utilized and the level of unemployment is unacceptably high. In initiating new programs of expansion, therefore, we can call upon unused resources, upon credit ease and fiscal expansion, and even upon a reasonable budget deficit for a limit period of time, without running the risk of inflation.

There are, of course, inescapable physical limits on the speed with which our untapped reserves can be put to use. Nevertheless, the current recession makes a modest and temporary deficit not only inevitable, but actually desirable as a stimulant to recovery and the resumption of economic growth. The fact is that a budget deficit may prove helpful in a period of widespread unemployment such as the present one. During periods of prosperity, of course, we should return to balanced budgets and surpluses.

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It is now clear that revenues in fiscal 1962 cannot help but be less than those projected in President Eisenhower's final budget message of January 16. In that message, corporate profits for calendar 1961—on which, of course, fiscal 1962 revenue figures are based—were estimated at $46 billion. The facts now available indicate that this estimate is too high, possibly by as much as $3 billion. In addition, personal income may fall somewhat short of the $415 billion estimate in that message.

I cannot pinpoint revenues and expenditures more exactly since final decisions have not yet been taken by the President. However, the Director of the Budget will be able to provide you with these estimates when he appears before you later this month.

In past recessions the Federal Reserve has been able to promote the needed lower long-term rates of interest by allowing the short-term rate to fall almost to zero. In 1958, for instance, 90-day bills sold at six-tenths of 1 percent. This tended to lower long-term rates and, in turn, promoted economic recovery.

It is important here to recognize that extremely low short-term rates are not of themselves necessary for recovery. They reflect increased credit availability and help stimulate the investment flow into the long-term sector at lower rates. Today, a reduction in long-term interest rates, including mortgage rates, is just as necessary as in previous recessions, but we must find new tools to achieve it.

No longer can extremely low short-term rates be permitted to result from credit easing steps taken to achieve our recovery objective. Instead, moves have been made to stabilize the short-term rate around present levels, an adequately low rate for business purposes. There is always the danger that a lower rate may precipitate a renewed flow of short-term capital abroad which could once again affect confidence in the soundness of our dollar. This we cannot allow to occur.

Therefore, other means must be found to promote lower long-term rates—means that do not immediately involve downward pressures on short rates. It was this dilemma that led the Federal Reserve Board to the conclusion that the "bills only" policy which had worked effectively in earlier recessions was no longer appropriate to the task at hand.

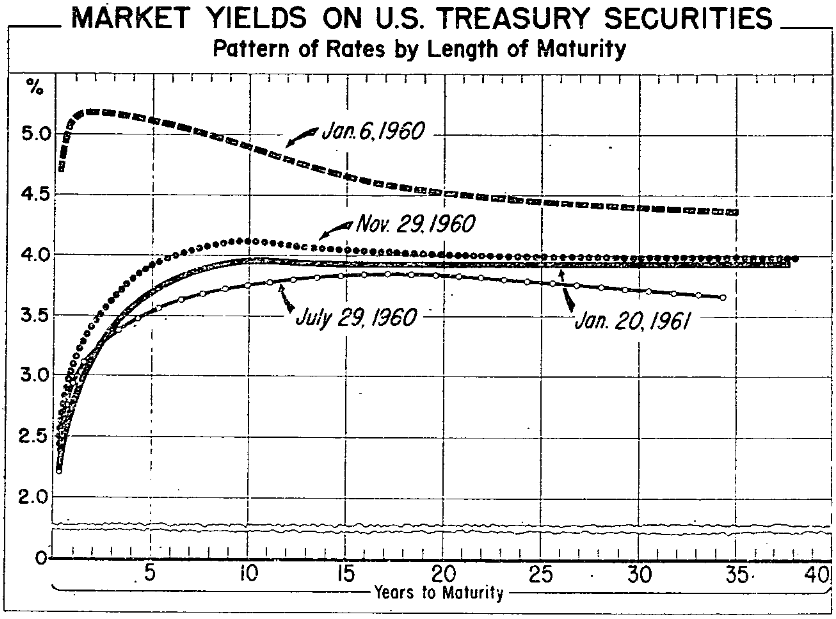
In addition, the Treasury can and should support efforts to lower the long-term rate by judicious debt management policies, not forgetting, however, the need for some lengthening of the debt so as to maintain a reasonable refunding pattern.

Recent developments in this field can be seen from the two charts before you which show the market yields on U.S. Treasury securities for selected dates.

The first chart shows that the high point last year was reached in January, and the low point the following July. It also clearly shows that long-term rates actually moved up as the recession deepened toward the end of last year—indicative of a lag in the availability of credit to borrowers.

(Chart 1 follows:)

CHART 1



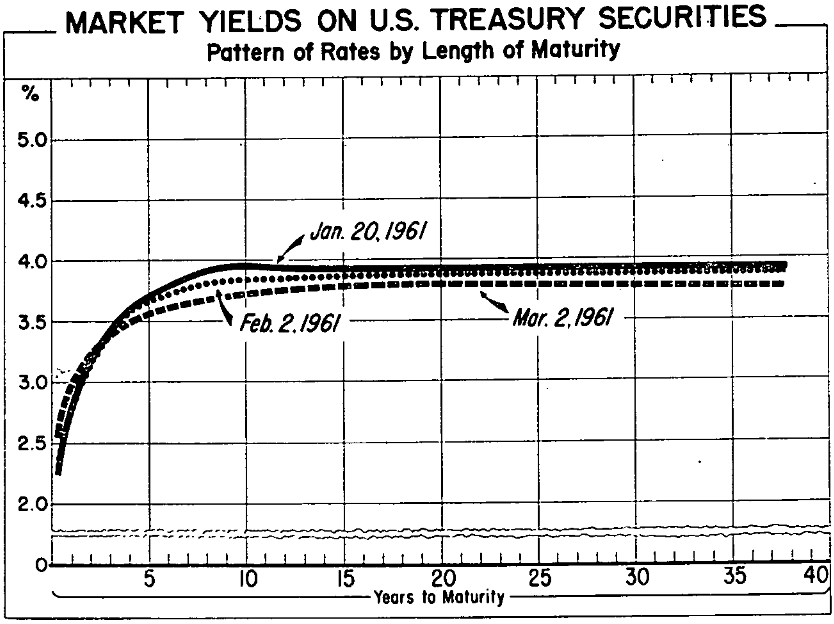
Secretary DILLON. The second chart shows that a decline in rates has occurred since Inaugural Day and that a further decline followed the President's economic message, in which he specifically called for maintaining short rates at current levels and a greater availability of long-term credit at declining rates.

This decline in long-term rates, coupled with the maintenance of short-term rates, was helped when the Federal Reserve last month began buying Government notes and bonds of varying maturities, some beyond 5 years, for virtually the first time in a decade, and the Treasury concentrated its sales of securities in the short-term sector.

The effect of these policies is, of course, to decrease the supply of long-term securities and increase the supply of short-term securities.

(Chart 2 follows:)

CHART 2



Secretary DILLON. Our attempts to try to bring about a greater availability of credit at lower interest rates in pursuing recovery and growth are certainly justified by recent developments. There has been a notable lag in certain key areas such as housing and municipal and corporate investment. Yet these are the very areas which we wish to stimulate.

Let me briefly examine these three specific areas:

First, housing: Although in housing the availability of credit at lower mortgage rates is only one aspect of the problem, it is nevertheless an important one. We are hopeful that efforts of the administration to lower mortgage rates—by reducing the Federal Housing Administration rate, placing more emphasis in the Federal National Mortgage Association program on buying rather than selling mortgages, and urging key mortgage lenders to lower their rates—will help to speed up a decrease in long-term mortgage rates reflecting the increase in available mortgage funds that is already beginning to manifest itself.

Second, security offerings of municipalities and State and local governments: Ordinarily, as interest rates decline, and funds become increasingly available in a recession period, such offerings increase. However, in the current recession, this pattern has not as yet been discernible. As late as last month, offerings continued to lag somewhat below a year ago. But as the credit ease continues, we can expect some growth in constructive municipal borrowing. Estimates for March project a considerable increase over the corresponding month last year.

Third, the corporate financing field, where the stock market seems to be openly inviting additional equity financing—an invitation we hope will be increasingly accepted by corporations. For the more corporations that turn to the securities markets and repay their bank loans, the more the banks will be able to supply credit to other borrowers, and so stimulate recovery.

There is another vital force in this whole area of interest rates and the availability of funds generally, and that is in the field of tax policy.

I shall defer discussion of this subject in view of the recommendations which the President proposes to submit shortly on tax measures that will encourage the expansion and modernization of the Nation's productive plant so as to accelerate economic growth and improve the international competitive position of American industry.

It will perhaps suffice to state the basic goal of our tax policy. It is simply this: to develop and maintain a strong tax system which will meet the revenue requirements of the Government, contribute to economic stability, and further the objectives of a dynamic and growing economy.

The tax system should be flexible and respond to changing economic conditions. In times of falling income, the receipts under such a tax system should decline, so that resulting Federal budget deficits will help to sustain the level of demand and employment. In times of rising income and employment, the system should furnish increasing revenue and a surplus should result.

An important advantage of the surplus will be that through debt retirement, it can be made available to private investors for capital formation and economic growth. We are looking forward to a strong economy in which such years of surplus will match or exceed those of deficit.

The problems of bringing about a prompt recovery and, more importantly, vigorous expansion, call for the stimulating potential of a larger Government budget within a financially orderly framework. We aim to make Government's contribution to economic activity in a way that will provide solid support—rather than mere temporary stimulus—to the flourishing and continuing growth we can and must achieve.

We hope that by carrying out these many-sided programs with resolve and determination, we can make maximum use of our resources, both human and material, to create a brighter future for all Americans.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Dillon.

Senator Sparkman is compelled to go to another meeting, the OECD hearing. Without objection, he will be allowed to ask his questions first.

Senator SPARKMAN. Mr. Chairman, it is not a hearing. We have an executive session for reporting it out. I notice that Secretary Dillon two or three times stated how much they are relying on that to help out in this program. I think I probably had better go there, Mr. Secretary.

There are a great many questions that I would have. It is a fine presentation that causes many questions to come to mind. I will hold myself to two or three.

First of all, I was interested in what you said with reference to housing, particularly the policy or the emphasis, you said, in the Federal National Mortgage Association to buy mortgages rather than to sell.

Are you, ex officio, a member of the board of the association?

Secretary DILLON. The Under Secretary of the Treasury for Monetary Affairs is just being appointed to the board of the FNMA, Mr. Roosa, and he will be following that closely from now on.

Senator SPARKMAN. He will be representing your Department on that board?

Secretary DILLON. That is correct.

Senator SPARKMAN. I just want to say that I earnestly hope that you will follow this policy and that you will lay emphasis on that. I have felt that one of the great drawbacks in a healthy housing program has been the fact that ever since we changed the law in 1954, and Congressman Patman will remember this, the Federal National Mortgage Association has been more interested in paying regular dividends to the purchasers of its stock than it has to rendering service to the homebuilding industry.

Senator Bush has heard me criticize them many times for that. I think you can do a great deal of good to the homebuilding industry, to continue the policy that you have stated here this morning. I hope that you will.

The next thing I want to get to relates to the very last part of your statement, and that is regarding the tax program. Yesterday we had the Council of Economic Advisers before us, and I called attention of the Council particularly to a piece of legislation that I had been advocating for some time, Congressman Curtis of this committee has been advocating in the House, and it has been the unanimous recommendation of the Senate Small Business Committee repeatedly.

I think it would be one of the finest pieces of legislation that could be agreed to in connection with the present recession. That is what we call the plowback proposal, to give to business the privilege of reinvesting in plant, plant equipment, plant expansion, inventory, 20 percent of its earnings or $30,000, whichever is less.

Staff members of the Senate Small Business Committee have talked to some of you people. I wrote you a letter about it a couple of weeks ago. I just want to say to you, Mr. Secretary, that I hope the most earnest consideration will be given to that legislation.

I think it would carry out exactly what you are talking about in the latter part of your program, particularly as it pertains to small business. Small business would be the one that would feel it most greatly, although it would apply to everyone. After all, small business is responsible for 50 percent of the employment in business in this country.

I simply wanted to get that point in. Now, Mr. Chairman, if you will excuse me, I will go to the Foreign Relations Committee meeting. Thank you.

Chairman PATMAN. Certainly.

Mr. Secretary, it has been good to learn that the West German Government and the Netherlands Government have both revalued their currency, and also that the gold outflow had stopped as of a week ago. I believe you are to be congratulated for both of these accomplishments.

What has been the effect of the order which prohibits U.S. nationals from owning gold abroad? Do you have any indication as to how much gold was owned by U.S. nationals in Europe?

Secretary DILLON. No, Mr. Chairman; we have no such information, and I do not think it would be possible to get adequate and worthwhile information on that subject. We do know that last fall there was a flow of undetermined but substantial amount, probably in the hundreds of millions of dollars, from the United States to Europe for the purpose of purchasing gold. But we have no way of estimating the exact amount.

We assume that under the law, the great majority, if not all of these Americans would be law-abiding, loyal citizens, and will comply with the law by disposing of their gold holdings prior to June 1. But it will be very difficult to police and check up on that, although we do try as well as we can, we will try as well as we can, through information we can develop from our embassies abroad and other means.

Certainly if after June 1 any person is found not to have turned in his holdings, the full force of the law will be used against him.

I would like to say one thing about this current cessation of the flow of gold out of this country. I think it is a fine thing. It is really indicative of a sudden, sharp dropping in the balance-of-payments deficit. I am not sure that we can yet count on the fact that the outflow has totally ceased. I think there will likely be a continued flow, but I think of a very much smaller kind than we have had for the past several years.

Chairman PATMAN. In your statement, you said, in effect, that our balance of payments position was improving throughout 1960. I just wonder why the sudden run on the gold last October.

Could you give us a brief comment on that, Mr. Secretary.

Secretary DILLON. Yes, Mr. Chairman.

The answer, to expand a little bit on what I had in my statement, is that last year we did have a real improvement in our basic deficit, which was almost entirely in the area of exports and imports, our trade balance, where our exports picked up something like $3.5 billion and our trade balance improved accordingly.

On the other hand, beginning around last June, when our economy here began to show signs of weakness, the Federal Reserve Board started to lower the rediscount rate, which had been 4 percent. They lowered it first to 3.5 percent and then 3 percent, and short-term rates followed this down very rapidly.

At the same time, there were boom conditions in Europe. The rates in Europe, the discount rates, had also been 4 percent rather generally. The German rate was 4 percent, and I think the British rate was 5. But there was not enough difference there to cause any outflow.

But the German authorities in June, in an effort to restrict their own boom, increased their rate to 5 percent, at the same time we were going down, and the British, in order to protect themselves so that funds would not flow from them to Germany, increased their rate to 6 percent.

So you had a point in the fall where our rate was 3 percent with a 5-percent discount rate in Germany and 6 percent in London, which produced this possibility for short-term holders of funds to transfer their funds and invest them in short bills, in London, primarily, but also in Germany and other countries on the Continent, and make very considerably more money than they did before.

In previous recessions, that had never been a real possibility because these currencies at that time, in the 1957–58 recession for example, were not convertible, so no American company, or very few, would willingly transfer funds abroad when they would not know that they would get them back. But now that there is convertibility, they flow freely.

This flow was of two parts. One was European countries bringing funds back and the other was American companies with corporate resources lying in New York which transferred them in very large volume abroad. That flow totaled probably something like $2 billion, or nearly $2 billion.

The fact of this sudden and sharp flow, whenever these funds were transferred to London—and the British keep practically all their reserves in gold—reacted on the outflow of gold from the United States, because the British authorities would transfer the dollars into gold when they got them in London.

That gold outflow shook some confidence among speculators generally, so that in turn a certain amount of our gold outflow was obviously due to decreased confidence in the dollar last fall. It was not possible to remedy these influences completely at that time.

President Eisenhower took some strong steps against the basic problem of balance of payments in his orders regarding procurement here in the United States for foreign aid and military expenditures. But it was necessary to wait for the new administration to come in and make its statement of policy before we could calm the hopes of these speculators. Naturally they were waiting to hear what the new administration would say its policy was on maintaining the value of the dollar, and they would not listen to anybody else.

So when President Kennedy made his original statements immediately after his inauguration, they took those at face value and the speculative fever has stopped and the outflow of funds from that has all finished.

Chairman PATMAN. Thank you, Mr. Secretary. I shall not ask you any more questions. I do want to comment and that will take up my time.

It is the desire of our committee to give each member an opportunity to interrogate you and all other witnesses. We take only a limited amount in going around the first time.

Without objection, I will insert into the record at this point certain statements and excerpts in explanation, without taking time to read them in full.

May I invite your attention to the fact that on October 17, Secretary Anderson made a speech in Fort Worth, Tex. It was rather a significant speech. Immediately after that, the price of gold began going up in London.

I will insert in the record the prices each day during that time.

(The material referred to follows:)

Gold prices in dollars per ounce, October 1960

Date	Zurich		Paris	Geneva	
	Buy	Sell	Sell	Buy	Sell
Friday, Oct. 7	35.18	35.47	35.77		
Monday, Oct. 10	35.18	35.47	35.83	35.28	35.49
Tuesday, Oct. 11	35.18	35.47	35.83	35.28	35.49
Wednesday, Oct. 12	35.18	35.47	35.83	35.28	35.53
Thursday, Oct. 13	35.18	35.47	35.83	35.28	35.53
Friday, Oct. 14	35.18	35.47	35.89	35.28	35.53
Monday, Oct. 17	35.22	35.50	35.89	35.28	35.53
Tuesday, Oct. 18	35.32	35.62	35.99	35.39	35.64
Wednesday, Oct. 19	35.40	35.76	36.08	35.46	35.77
Thursday, Oct. 20	36.85	40.46	39.00	36.91	39.08
Friday, Oct. 21	36.12	38.29	37.48	35.46	38.85
Monday, Oct. 24	36.85	39.01	38.18	36.91	40.52
Tuesday, Oct. 25	36.12	38.29	38.05	36.91	40.52
Wednesday, Oct. 26	35.76	37.21	37.35	36.18	38.35
Thursday, Oct. 27	35.40	36.48	36.46	35.46	37.63

Sources: Neue Zurcher Zeitung and Journal de Geneve.

Prepared by John C. Jackson and Elizabeth Boswell, Economics Division, Legislative Reference Service. The Library of Congress, Feb. 15, 1961.

London gold market

	Price		*Price*
Oct. 10, 1960	$35.21	Oct. 24, 1960	$37.75
Oct. 11, 1960	35.21	Oct. 25, 1960	38.00
Oct. 12, 1960	35.21	Oct. 26, 1960	36.60
Oct. 13, 1960	35.22	Oct. 27, 1960	35.75
Oct. 14, 1960	35.23	Oct. 28, 1960	36.50
Oct. 17, 1960	35.32½	Oct. 31, 1960	36.00
Oct. 18, 1960	35.33	Nov. 2, 1960	36.50
Oct. 19, 1960	35.60	Nov. 3, 1960	36.35
Oct. 20, 1960	40.00	Nov. 4, 1960	36.18
Oct. 21, 1960	36.50		

Chairman PATMAN. Secretary Anderson, quoting from the Evening Star in Washington, said in Forth Worth:

Treasury Secretary Anderson warns that the Democratic platform would breed inflation—debasing the dollar, increasing the flow of gold out of the United States and shaking the free world's economy.

Addressing a Republican rally in Fort Worth, Tex., on Monday night, Mr. Anderson called for election of the Nixon-Lodge ticket to continue the Eisenhower administration's "prudent" policies.

Turning to the report from the Fort Worth, Tex., Star-Telegram, it says:

Like a great many schemes, this one has fatal faults. If our Nation's growth is artificially forced by excessive money creation through Government borrowing, then we have merely adopted a new route toward currency debasement.

He used the phrase "currency debasement" there.

Heavy Government borrowing to pay for nonessential programs, Mr. Anderson said, would lead to inflation. Besides damaging the United States domestically, he warned inflation in the 1960's would weaken the whole free world.

Explaining the "new" dangers of inflation, Mr. Anderson said the United States now is the "banker" for the free world. Other nations keep much of their cash in American banks or invest their money in short-term securities of Government and industry, he noted.

Foreign savings and investments here total about $17.5 billion, Mr. Anderson estimated. He observed that foreigners can easily pull their money out of the United States by purchasing gold.

This will not happen, he said, "so long as they continue to have confidence in the dollar." He added:

"Confidence in the dollar is synonymous with confidence in the way we run this country of ours—our insistence on prudent fiscal operations, sound monetary policies; and business and labor measuring up as free men to their responsibilities."

Mr. Anderson said another danger of inflation involves the dollar's status as the free world's "basic reserve currency"—used by many nations to supplement gold as backing for their currencies. He warned:

"If ever confidence in the dollar is impaired, the monetary systems of all of the world's free nations would be dealt a severe and damaging blow. With much of the base for their own currencies impaired, their money to support production and trade would inevitably shrink. Commerce would be disrupted, depression and unemployment could set in. In short, international communism would have gained a tremendous victory without firing a shot."

This is part of the statement. You will notice that the London gold market on October 17, at the time the speech was made, was about $35.32. Well, the next day it was $35.33, the next day $35.60, and the next day $40, less than 3 days after the speech was made.

I will also insert into the record an article from the London Times of November 4, 1960, page 19, on "Second Thoughts on the London Gold Rush, Influence of the American Purchases."

(The article referred to follows:)

[From the Evening Star, Washington, D.C., Oct. 19, 1960]

ANDERSON SEES INFLATION WITH DEMOCRATS

Treasury Secretary Anderson warns that the Democratic platform would breed inflation—debasing the dollar, increasing the flow of gold out of the United States and shaking the free world's economy.

Addressing a Republican rally in Fort Worth, Tex., on Monday night, Mr. Anderson called for election of the Nixon-Lodge ticket to continue the Eisenhower administration's "prudent" policies.

The Democratic platform, Mr. Anderson said, "would add billions of dollars to Government spending."

If the Democrats redeem their platform pledges, he said, "we would either have to raise taxes or increase the national debt by borrowing." He discounted Senator Kennedy's assertions that he would balance the Federal budget except in periods of national emergency or severe unemployment.

WEAKEN FREE WORLD

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WARNS AGAINST INFLATION

Mr. Anderson said the Eisenhower administration's achievements in curbing inflation and thus protecting the dollar will be destroyed "if ever we permit inflation to again gain the upper hand—if ever we shift back to the discredited policies of perpetually easy money and excessive deficit financing."

Mere talk about fiscal integrity is not enough, he said, declaring that "the important thing is * * * the integrity with which one spells out exactly what will be done; exactly how much it will cost; and exactly how it will be paid for."

[From the Fort Worth (Tex.) Star-Telegram, Oct. 18, 1960]

ANDERSON WARNS INFLATION IS THE CRUELEST TAX OF ALL

Inflation is "the cruelest tax of all" and the Democratic platform as enacted at Los Angeles will add billions of dollars to Government spending, debase the dollar, and result in a tremendous victory for international communism without the firing of a shot, according to Secretary of the Treasury Robert B. Anderson, a Burleson native.

Anderson in a major WBAP televised address at a Texas Democrats for Nixon and Lodge rally at Will Rogers Memorial Coliseum, Monday, did not call Democratic presidential candidate, John F. Kennedy, by name but struck hard at his frequent campaign assertion that a higher rate of economic growth will generate more taxes.

"They [the Democrats] maintain that we can do all that we are doing now and much more without increasing the tax burden," Anderson told a crowd estimated at 2,000 persons.

"They argue that a higher rate of economic growth would automatically generate large Government revenues.

"Like a great many schemes, this one has fatal faults. If our Nation's growth is artificially forced by excessive money creation through Government borrowing, then we have merely adopted a new route toward currency debasement."

"This can result only in increased taxes—paid by the people—or an increase in the national debt by borrowing," Anderson said in declaring prolonged inflation will result in Government controls and "stringent and widespread direction of your economic life."

"American factory workers," he continued, "after inflation of the Truman administration was wiped out, have had what amounts to an increase of $12 per week in the last 7 years," Anderson said, "and the average family income has risen by 17 percent." (This due to increased value of the dollar.)

"Inflation hits hardest those least able to pay," Anderson continued, "the aged, and disabled, beneficiaries of life insurance policies, and those living on fixed incomes from social security and other savings, and those saving for their own futures."

Consumer prices rose 47 percent under Truman and only 10 percent under President Eisenhower's administration, he pointed out.

Former Gov. Allan Shivers, head of the State Democrats for Nixon and Lodge, introduced Anderson. Atwood McDonald, county chairman for the group, presided.

Both Anderson and Shivers spoke at noon Monday at a luncheon attended by about 400 in the Crystal Ballroom at Hotel Texas.

[From the London Times, Nov. 4, 1960]

SECOND THOUGHTS ON THE LONDON GOLD RUSH INFLUENCE OF AMERICAN PURCHASES

ONE-THIRD UNITED STATES

What has happened is the simple fact that by converting their large current dollar surpluses in August and September in London, rather than at the Federal Reserve in New York, certain European central banks created doubts both in the U.S. Treasury's willingness to convert foreign official dollar holdings freely into gold and in the effectiveness of the international official gold arbitrage system. On the basis of those doubts—which meant that the peg of the U.S. Treasury price for the London quotations, after having been very effective for 6½ years, had gone—it did not require much to set the ball rolling.

In contrast to a widespread opinion, the boom was not touched off a fortnight ago in Zurich; Zurich, a very sensitive barometer for international financial opinion, was only drawn into the arena at secondhand by a panic in the United States, and it was the first center which, on Wednesday last week, by its sales brought the temperature down by some degrees. It still remains uncertain whether it was simply the improving election prospects of the Democratic presidential candidate or the misinterpretation of some statement by Mr. Kennedy which set the gold rush in the United States in motion. At any rate, the gold fever hit the United States from the Atlantic to the Pacific coast, and although it is almost impossible to gain a full picture of the amount of gold bought for and by the U.S. operators, because the origin of orders placed via continental European financial centers is being kept secret, it is probably not far off the mark to assume that something approaching one-third of the total orders passing through the London market during the past fortnight were on American account.

Here is the most serious aspect of the current wave of gold speculation. Even at the worst, foreign speculation against the dollar could never force the hands of the U.S. monetary authorities against their will and there can be no doubt that, if only for reasons of prestige alone, no U.S. Government whether Republican or Democratic, could deliberately contemplate devaluing the dollar by raising its official gold price under conditions prevailing at present in the United States at home or in the world at large.

VICIOUS CIRCLE

But the problem would at once assume highly dangerous features if the instability of the free gold price created serious doubts in the stability of the dollar within the United States. And nothing less than this has happened in the past 3 weeks. The speculation against the dollar by U.S. residents in the form of gold purchases at premium prices has been only one reflection of these doubts. Potentially even more dangerous—because free supplies of gold are relatively limited, since the same doubts which have stimulated demand have reduced current gold offerings—is the fact that during the past fortnight there has been something approaching a veritable "flight from the dollar" in European financial centers. Dollar deposits of the U.S. residents in Europe have been freely converted into European currencies and this movement, unless it can be stopped very rapidly, is bound to swell the dollar holdings of European central banks to excessive levels.

There is, indeed, a vicious circle emerging which could seriously embarrass the U.S. monetary authorities if it was allowed to run its course. And, while financial orthodoxy as well as an underrating of the free market forces as reflected by the London gold prices, has prevented the U.S. Treasury from stopping the wave of distrust at relatively low cost, when it first emerged some 3 weeks ago, it would even now probably be much less costly for them in the long run to bring the London gold price back to their official parity than to let things drift. It has never been a wise course in monetary affairs to take the view that speculators will burn their fingers. Under the prevailing conditions this approach in regard to the gold price could spell disaster because the longer the free gold price is quoted at substantial premiums, the stronger the distrust in the dollar is bound to grow and, within this process, European central banks will inevitably have to absorb far more dollars than they can reasonably be expected to hold. Central banks in Europe are in no doubt about their need to make a contribution in getting the position back to normal because, in the end, it will not only be the dollar or the stability and strength of the free world at large, but also their own national currencies that are at stake. But a change of approach in the official U.S. policy is clearly needed. While the final arbiter for the safety of the dollar is to be found in the economic and financial policy of the U.S. Government, that policy will labor under serious disadvantages unless the distrust caused by the persistent discounts of the dollar on the free gold price can be removed.

Chairman PATMAN. I will not take more time. The statements and newspaper accounts both here and abroad will carry the point I desire to make.

Senator BUSH. Will the chairman yield?

Chairman PATMAN. Yes, I yield.

Senator BUSH. Are you inferring that the sudden rise to $40 was a result of Mr. Anderson's speech?

Chairman PATMAN. You must draw your own conclusion about that, Senator.

Senator BUSH. You seem to have drawn yours, but I do not think you have made a case for it.

Chairman PATMAN. When the Minister of Finance for a country, Secretary of the Treasury in this country, refers to currency debasement in the form or manner that he did, I would think it would have some influence.

Senator BUSH. He was speaking in the abstract about the dangers of currency debasement, which are true. I am sure the Secretary would agree with his views.

Chairman PATMAN. You read this and I would like to have your evaluation on it and your conclusion that you arrive at. I shall be very glad to yield to the Senator from Connecticut.

Senator BUSH. I do not see the point of putting that type of material into the record. I do not think there is any basis for it at all. I object to that kind of a political maneuver in this kind of proceeding.

Chairman PATMAN. It is not intended as a political maneuver. It relates directly to this gold question.

Senator BUSH. Mr. Chairman, I will proceed.

I want to say first that I congratulate the Secretary on his comprehensive statement. In such a comprehensive statement, one would wish we might have it 24 hours in advance so that we may study it fully.

I am very glad to see that it shows some confidence in our situation. It is one of the statements showing some confidence that is very welcome. We have not been getting very many of those from the stations on the New Frontier, and I think it is time we had some. I am pleased with this one in that particular regard.

It is not so gloomy. It does show that we can take hold of our balance-of-payments problems. Then he gives some constructive suggestions as to how it may be done.

Mr. Secretary, this question of mortgage rates seems to trouble people or be a troublesome one. I find objection, on the part of some of our savings bankers in the East, that too high a return is being paid on savings deposits, particularly out West.

Here you find Government-licensed institutions going ahead and bidding up for savings at the same time we now find the Federal Reserve Board buying securities so as to make money easier. In other words, we have these agencies working against each other, which I do not think is very helpful to the situation.

I would suggest that inasmuch as I believe the Federal Home Loan Bank Board comes under the general purview of the Treasury, at least they have something to do or used to have something to do with the selection of its members, I would suggest that it be called to their attention and perhaps some persuasion might be used to persuade these associations out there not to work against the policy of the administration, so to speak; in other words, to cooperate here and not bid up for savings, not bid the rates up, which automatically puts mortgage rates up. I think that would be an important assist in the overall endeavor.

On this question of confidence, Mr. Secretary, when the World Bank and IMF group met here in September of 1959, the one thing they could not understand about the United States was its unwillingness to take the lid off the 4.25 percent ceiling, to remove the 4.25 percent ceiling on long-term bonds.

I have noticed Dr. Heller, the Chairman of the Council of Economic Advisers, is quoted as saying that he favors the removal of that ceiling. What is your view about it?

Secretary DILLON. Senator Bush, I would like first, if I could, to make a brief comment on the mortgage rate matter.

We have had this problem which you mentioned very much in mind, and I, myself, met with a group of presidents of savings and loan associations from the Los Angeles area about a week ago and spoke to them, not about their dividend rates, what they were paying, but about the mortgage rates, the rates at which they were lending on mortgages which seemed to be on the high side.

I found that there was a general agreement among them that this was so, and the feeling that this would gradually correct itself. We expressed the hope that this would happen relatively rapidly. I am sure that if that does happen, at the same time there has to be and will be a lowering of these dividend rates, because they could not afford to pay these high rates unless they charged high rates for mortgages.

In following this up, the President announced; I think last Wednesday, that he had asked the Chairman-designate of the Home Loan Bank Board, Mr. McMurray, to go out to San Francisco where there is a regional meeting scheduled of all the savings banks of that local home loan bank, which will be sometime this week.

Mr. McMurray is going out there to carry this message of hope that action can be taken to bring mortgage rates down to a somewhat more realistic level in that area. They were up over 7 percent. They have already come down somewhat, but we think that they should come still lower.

Now, as to the 4.25 percent ceiling on the coupon rate, it is my feeling that theoretically this ceiling does not make a great deal of economic sense, provided one can have confidence in the way the money managers, which is the Federal Reserve and the Treasury, handle their affairs. Apparently the reason it was imposed was that the Congress lacked a certain amount of confidence in how we, the Treasury, would handle our affairs.

For the moment, at the present time, we can operate, we feel, within this ceiling without any major difficulty. That is because rates have gone down. Moreover, the question of whether or not to ask for a change in the ceiling is in a sense academic because in 1942 Congress permitted the Treasury to issue bonds at a discount. However, if at any time there should be a real reason for changing the ceiling, we would not hesitate to make that request. We have made, and I think we are making, certain advances and improvements in the way the Government money market is being handled, and it may be that some of those who felt a lack of confidence will now, as a result maybe also of this very comprehensive study that was made by this committee of the functioning of the Government market, concur in its indication of a general satisfaction, particularly with the functioning of the short-term area of the market.

Senator BUSH. I suggest, Mr. Chairman, that a good time to handle an issue like this is when it is not quite so hot as it was a year or so ago. My good friend from Illinois is now in a very happy and calm and liberal frame of mind and we might get him to go along with it, if the administration came up to remove this ceiling, with a bill to remove this ceiling at the present time.

I express the hope that the administration will consider that course. I yield the floor.

Chairman PATMAN. Senator Douglas.

Senator DOUGLAS. In view of the gentle needling from my friend from Connecticut, may I say that I think the opposition many of us had for lifting the ceiling last year was well justified. The then Under Secretary of the Treasury, Mr. Baird, in a speech which he delivered, declared it was the intention of the Treasury to refund approximately $20 billion of securities and to refund them on a relatively long-time basis, not all of them, of course, at once.

As I remember it, an initial refunding was made at 4⅞ percent, and there was talk of 5 percent. It was our contention that this was an unduly high interest rate, and that the 4.25 percent should be maintained, and that an effort should be made to get a more competitive interest rate with, at the same time, simultaneous reforms introduced by the Federal Reserve.

We are going to examine Mr. Martin this afternoon. I understand from his statements that he is already introducing some of the changes which last year we thought were proper but which he refused to introduce last year, namely, that the circulating medium should be permitted to expand through open market operations rather than lowering reserve ratios, and that in doing this, the Federal Reserve should purchase long-time securities and not confine itself to bills only.

There may be some reforms in the securities market which are in the offing, too. So we are beginning to get action there. Speaking only for myself, may I say that I would be willing to remove the 4.25 percent ceiling if I felt that there was a serious effort on the part of the Reserve and the Treasury to make these reforms which they refused to make last year, but which apparently there is some move to make this year.

I can speak only for myself. And I would say that the action of the Democratic members in refusing to allow a 4⅞ or 5 percent interest rate to go through has saved the taxpayers of the country literally billions of dollars. We have, therefore, been justified by what has happened.

But if there is now, as we believe there is, a disposition on the part of the new administration to clear up some of these matters, I would agree that I think the 4.25 percent interest maximum could be removed.

Now I would like to ask in accordance with this two or three specific questions along these lines.

Last year, the majority of this committee recommended, and the previous Secretary of the Treasury did not act upon, suggestions which we made that in the issuance of long-term bonds an experiment be made to subject them to auction and competitive bidding instead of issuing them at a fixed price.

It was our believe that the fact that these issues were oversubscribed at a fixed price showed that in a competitive market the price would probably be higher, the yields, therefore, lower, and it was our belief that this would result in a lower interest rate.

I know that you may not wish to make a commitment, and I am not pressing you for a commitment. But I would like to ask whether you are studying this question of auctioning long-time bonds in preference to their issuance at a fixed price.

Secretary DILLON. We certainly are going to study that and see if it can be done. Presently the longest we are doing is 1-year bills, and there we did run into certain difficulties which have led Treasury to reduce the original size of three of the 1-year issues from $2 to $1.5 billion. This is a very difficult problem, but we certainly keep an open mind on it.

We want to find a way to handle our Treasury bond operations at the lowest cost possible to the Government. It is a question of judgment as to which way would be the lowest cost.

I think one would reach agreement that one of the problems here is that in any shift of this nature, any experiment of this nature, to go to competitive bidding for long-term Government bonds, because of the size of the issues and the probable caution of the dealers in not wanting to lock up their funds in such issues before they were sure they could resell them, would mean that on the original attempt to use a mechanism like this you would almost inevitably pay a higher cost than under our present system.

The real question is if after two or three or four attempts, would that not lead to a different atmosphere and to the cost coming down? If we could try it once and get the answer, that would be easy, but we know it is not that easy. It is a thing we would have to make some sacrifice on and we would not be sure where we would come out at the end.

Senator DOUGLAS. Is not the general rule true that if at a fixed price several times the issue is asked for, that this is an indication of a competitive market, and that you would therefore get a higher price?

Secretary DILLON. I do not quite think so, Senator. I think the basic evidence I would take is the price at which the issue sells after it has been distributed. I think the record shows, and I have looked into this not adequately, but briefly, that on long-term Government securities the average is that issues sell at a premium of about 11 basic points on a yield basis over what they have been offered at.

That is running back over a number of years. Say we offer them at a yield basis of 4 percent. They would move to a yield basis of 3.89 in the public market 2 or 3 weeks later or a week later. That, I think, is the true measure.

Senator DOUGLAS. That is one-ninth of a percent.

Secretary DILLON. Yes; that is one-ninth of a percent, which is the cost of the distribution. In the history of corporate and public utility bonds, the only figures we have available are a mixture which are corporate bonds which are generally sold through underwriters on a negotiated basis, and public utility bonds which, as you know, are all sold on a competitive bidding basis.

Public utility bonds are probably more in volume than the corporate ones. But the average spread there is higher than this Government's 11 basis points. It comes close to a quarter of 1 percent or even higher, between 25 and 30 basis points.

I am sure you have to have some differential there or people will not come in and buy. The volume of subscriptions is sometimes, as you know, padded by people who think the thing will be a success and they put in more than they really want.

It is a difficult problem, but it certainly is something that I think should be explored. Probably the only way it can be explored is by an experiment.

Senator DOUGLAS. That is very reassuring.

There is a second recommendation which the majority made; namely, that Treasury should help us in proposing to plug the so-called loopholes in the tax system to the end that people with equal incomes should pay approximately equal taxes.

Would it be premature to ask you your judgment on that?

Secretary DILLON. I think this is a philosophy which in general we would be in accord with. Of course, when you get down to the specifics, you run into a great many difficult and complex problems.

I think it would be appropriate to say at this time that our general plans in the tax field look to formulating and suggesting for enactment at this session of the Congress legislation that would provide a stimulant to modernization of plant and equipment, which we think is very necessary, not just as a recession measure but to keep our plant more productive and more modern so it can be more competitive with the plants in other countries, friendly countries, competitor countries abroad.

This will probably be supplemented by certain measures to increase revenues by closing or changing certain things that have been characterized as loopholes in the past. But we are not planning on making any suggestions for a complete and major overhaul of the tax structure at this time.

We do want to look at the whole structure during the course of this year, and we would hope the result of that study would put us in a position to make overall recommendations on the tax field for consideration right at the beginning of the session next year.

Senator DOUGLAS. Mr. Chairman, I think we are beginning to get a reconciliation between the views of the majority of this committee and the Treasury and Federal Reserve. Echoing the desire for harmony which my good friend from Connecticut so eloquently expressed, may

I express a similar desire that he cooperate with us in the progress which now seems to be underway.

Thank you.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Mr. Secretary, I have four lines of questions that I want to pursue. The first three really lead into the fourth, so I will ask the fourth first.

I gathered from your testimony that you anticipate deficit financing for this year and possibly next year. Am I correct?

Secretary DILLON. I do anticipate a deficit in the Federal budget for the fiscal years 1961 and 1962; yes.

Representative CURTIS. The size of it, of course, is going to be determined by the Bureau of the Budget report to us as to the expenditures.

Secretary DILLON. That is correct.

Representative CURTIS. What basis are you using, of economic growth or whatever, for estimating your revenues for the fiscal year 1962?

Secretary DILLON. Well, for the fiscal year 1962 we have made an estimate, which we feel is relatively realistic, of gross national product for calendar year 1961, because on that is where most of our revenues come.

So it really does not require any very long-term feelings about growth. But it is based on an upturn starting probably sometime in the second quarter of this year and carrying through to the end of the year.

I think that the difference in our estimates from those used in the budget document submitted on January 16 is that that was based on an upturn starting almost immediately in the first quarter, which we have seen has not been the case. In fact, there has been some further slide in this quarter from the fourth quarter of last year in our overall rate of investment, the Federal Reserve Board production index being down a point in January.

I do not think they had foreseen that at that time. I think that is the crux of the difference. Also, it seems from figures that we have that maybe corporate profits are being somewhat more compressed relative to the total GNP than had been thought at the time of the earlier estimates.

So, whereas there is a very small percentage difference in our view of total personal income, on which the estimate was $415 billion in the January budget—we think that will come very, very close to it—there is a rather substantial difference in the estimate of corporate profits, and that affects budgetary income quite a bit.

Representative CURTIS. May I ask if this has been cleared in consultation with the President's Council of Economic Advisers and the Cabinet level so that this goes beyond merely a Treasury estimate?

Secretary DILLON. This at the moment is the consensus which is arrived at in the same way that it is always arrived at, between economists in the Treasury, the Federal Reserve, the Bureau of the Budget, the Department of Commerce, and the Council of Economic Advisers.

I think there will be a more official estimate along this line, unless there is some change that I do not presently expect, between now and 2 weeks from now when the message comes up. In the President's budget message, which will come up in about 2 weeks, he will, himself, officially adopt one of these estimates. I do not think he has yet done so.

Representative CURTIS. I am happy to hear that. Incidentally, I might say this is in conformity with the testimony given to the Ways and Means Committee by the Department of Labor when we were considering the temporary extension of unemployment insurance programs. I regret to say it was missed by the press and a lot of people.

The whole concept of what we were asked to do in extending the period under which a man could receive unemployment insurance was that the upturn was going to be beginning around April. That was in considerable contrast with some of the statements that were being made that were not relating to actual economic appraisals, but rather, pointing up attention to the individual or the community problems that unemployment and a recession always bring about.

The first line of questioning—and my time may run out as I get into it—is in regard to this international picture. For my own convenience, I have always tried to separate the U.S. position into three, (1) as a world banker, which I believe we are now; (2) as a world trader; and (3) an investor.

It helps me if I try to relate those three areas separately. I think we have been doing pretty well as a world trader, particularly in the year 1960. Is that your opinion?

Secretary DILLON. I would think that is very true. Efforts last year in world trade were very satisfactory. Of course, we were aided by one important situation which will not always occur, and that is that there was a substantial boom in the countries which are our major markets, in the countries of Europe and Japan, whereas, business here was a little slack so that the demand on imports was not as high. I think that is one reason why we had such a favorable showing.

Representative CURTIS. Most people I have heard think that this coming year is still going to be a good trade year for us.

Secretary DILLON. I think it will be just as good. My personal view is that it will be in every way as good. The probabilities are we may have some decreases in some items, such as exports of cotton which were possibly higher than average last year. But there ought to be some areas where we will gain.

For instance, late in November 1960, the Italian Government removed discriminatory restrictions on a whole host of industrial products. There was no chance to get any benefit from that during last year. There were other similar removals of restrictions during the course of the year, of which only partial advantage could be taken, but of which full advantage can be taken this year. I think with that in mind our exports should maintain about the level they were last year.

Representative CURTIS. Now, turning your attention to the United States as an investor, there are two factors, of course, the private and the public—the governmental. It seems to me one of the strongest areas that we have is in the private investing area.

We have very substantial and very nice balances in that area, do we not, although we may be frozen?

Secretary DILLON. There are very great assets which are often not fully appreciated when people look at our balance of payments situation. We have some $45 billion of investments.

Representative CURTIS. That is what I am coming to. Our balance of payments, actually, as I analyze it, and as I have heard others, is one where the problem lies in liquidity rather than a good credit over debit.

Secretary DILLON. Yes, that is true to some extent. It is the current situation which is our problem. We have been running certain current deficits on our balance of payments which have been in an ordinary accounting sense offset by long-term investments abroad. But the long-term investments are not immediately realizable so it puts us in a somewhat difficult position.

Representative CURTIS. One weak spot I see is the governmental investments field where, of course, we get into foreign policy, and we do not intend to have much of that strong investment. Some of that investment, at any rate, is recognized as not very strong. In fact, some of it is actually in grants.

Secretary DILLON. I think there is a real point. That is one of the most significant changes we have made to attack our balance of payments problem which was directed by President Eisenhower last November and which has been fully supported by President Kennedy.

That is that we will, wherever possible, tie our foreign aid programs, be they loans or grants, to procurement of goods and services in the United States, and, in the same way, in our military procurement for our own forces abroad we will, wherever possible, even at the acceptance of some budgetary sacrifice, try to buy the maximum here in the United States.

To the extent that we do that, these items are removed from the balance of payments because they do not have any effect on the balance of payments.

Representative CURTIS. I see my time has run out. I will come back because I still have not gotten to the key point.

Chairman PATMAN. Mr. Bolling?

Representative BOLLING. I have no questions, Mr. Chairman.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Mr. Secretary, it is a pleasure to greet you here, and especially to compliment you upon the great initiative of the OECD which I look forward to seeing come to fruition.

Mr. Secretary, I notice a prediction contained in your statement. I want to be sure that it is an advised prediction. That is where you say at page 3, "I am increasingly hopeful that if we utilize these elements properly welded together we can reach our goal within the next 2 years," and that relates to the imbalance of international payments. Is that a considered judgment on your part?

Secretary DILLON. Our hope is that if there are no untoward developments, sudden shifts in the world situation, that sometime during calendar year 1963 we ought to get into balance. That is our goal.

Senator JAVITS. I was bogged down in the New York fog yesterday—we do not have very many, but we did have one yesterday—and did not hear the Council of Economic Advisers. But I carefully read their presentation, and I find that they have a prediction, too.

I think you intimated to Congressman Curtis that you agree with it. They say, on page 8 of their statement, "A quickening pace of the recovery following the reversal of the inventory cycle mechanism does not appear likely until after midyear," as being a sort of key time to them when we might get over the worst hump in this recession.

Would you take yours, that is, the 2 years, and this one of the Council of Economic Advisers, and say that these are the two economic judgments on which the policy of this administration is now being based?

Secretary DILLON. Certainly I think their judgment as to the turn in the recession is the judgment of the administration at the present time. I think there may be somewhat too much emphasis put on that statement of the quickening of the recovery from help through inventory accumulation.

That would only begin, probably, after midyear, and it was read around the country as that recovery would only begin after midyear. That was certainly not the intention of Mr. Heller or of the Council.

Their feeling, I think, is very similar to mine, that recovery—and I think a close reading of the statement as a whole will show that—recovery will begin some time in the second quarter, but that the extra impetus from inventory accumulation will not come until in July or thereabouts.

Senator JAVITS. So that a relatively near turn or end of the recession and relatively a 2-year swing correcting the imbalance in balance of payments is a fair determination of the two judgments that the administration has made?

Secretary DILLON. I would say that the first one is an economic judgment and the second one is a goal that we have set for ourselves, and we hope we will be able to achieve it.

Senator JAVITS. I notice one other point of policy which is much emphasized. I find it reflected by you, I find it reflected by the Council of Economic Advisers, and that is an emphasis upon Government expenditure as holding the key to the economic goals which you gentlemen have been describing.

For example, they say, and I will quote it:

> The principal prospects for early expansion of demand lie in the continued upward trend in government purchases, Federal, State, and local, and increases in consumer spending with the aid of governmental income maintenance programs.

You say in your statement:

> The role of the Federal Government as an energizing force in the growth of our economy, as a stabilizing influence upon its ups and downs, is daily becoming more important.

Is it fair to characterize, therefore, the difference between what we have in this administration and what we had in the last administration as being a greater emphasis, a renewed emphasis, upon the role of the Federal Government as the generator of increased growth, rather than the role of the private economy as a generator?

Secretary DILLON. Well, I think you could only look at the record as to what happened. Certainly the actions taken in 1958 which led to the budget deficit in 1959 indicated a substantial reliance on Government expenditures to move out of the recession that we were then in.

I do not think it is a greater emphasis at the moment on Government versus private. I do think that it is possibly a greater emphasis on the use of fiscal policy as such, where it can possibly be used, rather than an extreme reliance on monetary policy.

Before, because of lack of convertibility, a great deal of reliance was put on lowering the short-term interest rate down to, as I said, almost zero, and thereby stimulating the economy because that helped to lower the long-term rates relatively rapidly.

We are still trying to get long-term rates lower by other means. I think greater emphasis, however, has to be placed on fiscal policy. On the other hand, we do feel that we should keep fiscal policy measures also within modest bounds.

The real question, it seems to me, is the bounds within which this sort of policy is kept, how it is operated. I do not think there can be much question about the desirability of the policy as such. I do not think anyone would say that we should aim at a balanced budget every year and when we have a recession and incomes fall under our tax system, our progressive tax system, that we should immediately cut expenditures just at that time.

On the other hand, I think we have to act prudently so our deficits should not be too large in those times, so that we can foresee surpluses that would have a possibility of offsetting them in good times. I think that is what we are trying to do.

Senator JAVITS. I notice, for example, that there is not nearly as much emphasis on incentives and there is far more emphasis on Government expenditure. For example, there is a singular silence on what a more effective activity in the civil rights field can bring about to our increase in productivity.

That has been estimated by Olveta Culp Hobby as high as $3 billion a year. There is not as much emphasis, perhaps, on what can be done in mixed enterprise, Government and business, in overseas development, which is probably, as you, yourself, intimated in your statement, the greatest opportunity which American business has.

We have heard less and less about such activities as those incorporated in the Boggs bill, to stimulate oversea investment, giving business, perhaps, the same opportunities we want to give young people, which I thoroughly applaud, in the Peace Corps.

Those are the kinds of things that I had in mind. Would you care to make a comment on that?

Secretary DILLON. Yes. I would say that possibly the reason that you do not see quite as much emphasis on incentives is the handicap that I am under today regarding any premature comment on proposals that will be made at the end of this month by the President in the tax field.

Certainly a very major part of our efforts, both in meeting the economic situation which faces us today and in handling this balance of payments matter and keeping ourselves competitive is a reliance on increased incentives to modernize plant and equipment.

We think this will also help in the general economy by giving substantial extra business for our makers of machine tools and small machinery. This will be a very key part of our program, but since the details of it have not yet been worked out, and since it will not be coming forward for about 3 weeks, I was not able to give it the emphasis that it deserves in the overall look at what we are really trying to do.

The other item which you commented on, what can come in the way of improvements to productivity through civil rights is, I think, very much in the President's mind, and I think is what largely led to the vigorous approach that is being taken in employment fields as indicated by the new Executive order of yesterday.

I think probably we were at fault in not translating that effect into economic terms as clearly as maybe we might have done, because I think it will give a stimulus to the economy. But just how much, we have not figured out.

We were considering it more as a question of justice, of economic justice, than as an antirecession matter.

Senator JAVITS. Thank you. My time is up, Mr. Chairman.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. I want to move on from where Congressman Curtis was going, Mr. Secretary. He talked about how well we had been doing as a trader and you said that our export-import balance had been very favorable recently.

Has any study been made of the relationship between our balance of trade and foreign aid, troop spending abroad, and other governmental influence on our trade balances?

Secretary DILLON. I would say there are constant studies of that nature, but that at the moment, with the European countries, certainly, and Canada, I do not think that the amount of exports that they take from the United States bears a great deal of relation to this because certainly in Europe most of these countries are largely surplus countries.

The first effect of reductions in American expenditures abroad would be on their surpluses rather than on what they would buy from the United States.

I would think that we have a good way to go before any changes in our procedures, such as buying foreign aid in the United States, would have an effect on our foreign trade balance.

Senator PROXMIRE. I have heard that our Public Law 480 program, and other foreign aid programs account for virtually all or in fact a great deal more than the favorable balance of trade and that if you allow for that we actually would have an unfavorable balance of trade.

In other words, this advantage we have as a trader is really artificial; that it is caused primarily by Goverment action and is not caused by more efficient production and lower cost operation in American plants and a healthy, competitive situation with the rest of the world.

Secretary DILLON. I would say that there certainly is a point there. Personally I have not been entirely satisfied with the way our figures on balance of payments have been presented heretofore, because I don't think they have made the situation exactly clear. We are presently engaged, in cooperation with the other interested departments, on a technical level, in studying this whole matter to see if better ways can't be found to present the facts of our balance of payments.

In this particular item that you are talking about there was a rather interesting table presented along with the President's message on balance payments. The figure that I think was in it showed a surplus on commercial exports, which excluded all these special governmental programs, of some $2.2 billion last year, instead of the figure that you see in the ordinary balance-of-payments tables that are published by the Department of Commerce, which shows a trade surplus figure of $4.7 billion.

In other words, about $2.5 billion of this surplus that is shown in the Department of Commerce's figures represented Public Law 480 exports and U.S. exports under other foreign assistance programs.

If you go back a year to 1959 and do the same sort of on operation you will find that instead of a trade surplus of $900 million we actually had a deficit in our commercial trade surplus. But last year we did do better and we had a surplus of about $2.2 billion, excluding all of those special items.

The way we present it also makes a problem from the point of view of foreign aid, because it makes it appear more important to the general public in our balance-of-payments situation than it really is, because these extra amounts that are included over here in exports are counterbalanced on the other side by the figure of grants and loans and it leads people to think that just by cutting these out you could immediately rectify a balance of payments, which is not exactly the case since most of the grants and loans are tied to U.S. exports.

Senator PROXMIRE. That is the point I was pressing to.

Secretary DILLON. It is not the case.

Senator PROXMIRE. Furthermore, it seems to me that this obscures what I think is the necessity for recognizing the great disadvantage of American industry in terms of cost of production. I think you will find a great deal of commonsense on the main streets of America, people recognizing, that foreign country's advantages in low wages and high skills plus investment of American capital abroad is resulting in a situation which threatens American jobs.

We have had a very constructive proposal on this and I would like your views on it, given by a man who appeared before our committee recently, who has been a free trade advocate. He suggested that we might consider establishing a quota system in which we would permit imports, encourage imports, providing they approach something like the American wage scale. And perhaps have a discouragement of imports which failed to approach the American wage scale.

I realize this is terribly hard to administer and apply. I am asking for your general impression of this suggestion to see whether you think it has any merit at all.

Secretary DILLON. Well, I think that the facts of the matter are that the U.S. wage scale generally is higher than any other country in the world, and the only one that approaches it is Canada. So if we were to discourage imports that didn't meet our own wage scale, we would discourage, automatically, all imports.

Senator PROXMIRE. What I am talking about, of course, is their meeting some kind of a schedule at which they approach it or come closer to it. It seems to me this is the way we can strike a blow for humanitarianism throughout the world as well as protect our own workers, and our own industry.

Secretary DILLON. I think the position, as I understand it, of the AFL-CIO on this thing is probably a very reasonable one, where they say that there should be attention paid to the wage situation in each country and any goods that are produced by substandard conditions should somehow be penalized. That I can understand, and I think by that sort of work they would help to gradually make wage scales around the world come up to the highest level in each country.

Certainly, the fact is that wage scales in Europe are mounting more rapidly than they are in the United States. In the long run, I would say that is a good thing, because it will tend to equalize standards of living in Europe and the United States, which we should be for. We should move ahead, but we would hope that they would come along and be more nearly the same as we are than they are presently.

Senator PROXMIRE. I guess my time has expired, Mr. Chairman.

Chairman PATMAN. Mr. Kilburn.

Representative KILBURN. Mr. Secretary, I am very sorry that I was not present for your statement, but ever since you first appeared before our House Banking and Currency Committee, I have felt especially glad that you became Secretary of the Treasury.

Secretary DILLON. Thank you, sir.

Representative KILBURN. I have no questions.

Secretary DILLON. Thank you.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. I, too, very much appreciate your constructive statement this morning, Mr. Secretary. I would like to inquire with you into one of the fundamental assumptions underlying that statement.

You have said that it is very desirable to get long-term interest rates as low as possible, and lower than they now are, to stimulate investment in housing, public utility expansion, and other capital expenditures. On the other hand, you have indicated that there is a roadblock to lowering the long-term interest rate as much as you would like in the international balance of payments situation.

You said specifically on page 6 that we have to stabilize the short-term rate at around the present level—that a lower short-term rate might precipitate a renewed flow of short-term capital abroad.

This assumption is an extremely important one. If you keep the short-term rate where the Treasury has indicated it ought to be, i.e., 3.25 percent for 18 months, the existing conventional relationships among rates for different maturities and types of obligations will bring us out with a mortgage rate for housing at something around 6 percent, or not very much lower than that.

Would you disagree with me?

Secretary DILLON. I would disagree to some extent; yes. When I talked about the short-term rate, this money that flows rapidly back and forth is usually more interested in the most liquid forms of securities, interest they might get on bank deposits or the equivalent here in the United States, which are 90-day bills.

The rate on that is presently around 2.5 percent. When I say around present levels, I would say somewhere around 2.5 percent to maybe a little lower, to 2.25 percent. Somewhere in that area is an area of stability. I would think that it is by no means a concomitant of 2.5 percent, 90-day money, that you have 2½ percent 18-month money.

I would think that over a period of time that the curve would not rise quite so sharply and that you could get lower long-term interest rates. I don't feel that this 2½ percent or 2¼ percent, whatever it is, level which we do have to maintain for short-term rates for balance-of-payments purposes is a roadblock, or should be permitted to be a roadblock in our efforts to obtain a proper long-term rate structure.

It just means that we have to use fine ingenuity to develop and use other methods for achieving the desired result. I think you have put your finger on what I think is probably one of the most significant things and which really is the central point in my whole statement, the interrelationship between the balance-of-payments situation and the weapons we use from now on to attack recession here at home.

Representative REUSS. Let me return to that. I applaud your ingenuity and the Fed's ingenuity in using purchases of longer-term U.S. securites as a method of rectifying this imbalance. But do that as much as you will, bury the "bills only" policy as deeply as you care to, I still am concerned lest an assumption that a given level of short-term interest rates is necessary, precludes our getting long-term interest rates to the desirable low level.

Isn't it true that the movements of short-term capital are not due mainly to interest rate differences but rather to the factor which you have also mentioned, general confidence in the dollar?

Of the $21 billion worth of short-term claims held by foreigners in this country, $4 billion or so are held by the international institutions which are not likely to go "over the bill." About $10 billion is held by foreign central banks and treasuries. Foreign central bankers are likely to want to be responsible and to keep a reasonable ratio between their dollar and their gold holdings. They are not likely suddenly to make outrageous demands upon us for gold. That leaves the $7 billion, more or less, held on private account by foreigners in this country.

I put it to you, Mr. Secretary, that a very large portion of even than $7 billion is held by traders who need the dollars for current trading operations. Therefore, I wonder if the actual amount of potential hot money which could cause trouble is not quite small. If that is so, are we not perhaps letting the tail wag the dog here in saying we have to keep short-term interest rates so high even if it prevents us from lowering long-term rates sufficiently?

Thank you for your patience in listening to the question.

Secretary DILLON. This is, of course, a real problem and a difficult problem, namely, the amount of money that would move backward and forward for interest rate reasons. There is a substantial quantity that would move for that reason, not irrespective of confidence factors, but because there is confidence now in the various currencies, including our own.

It is not just limited by the foreign deposits over here. A new development last year arose from the fact that very substantial amounts of U.S. corporate funds were moved in the same way and for the same reason. I was just looking at my figures and American corporations own some $20 billion of short-term U.S. Government obligations.

Certainly, a lot of that they have to keep here, as you say, for their regular use. But the amount that will move depends on the variation of the interest rate. In other words, if you can get a premium by moving idle funds to London of a half of 1 percent, maybe nobody would move, because moving funds is a bit of a problem.

The general feeling is that when you can get 1 percent additional a considerable amount of funds would move. If you get 1½ percent additional, other people who hadn't wanted to make the effort at 1 percent are then brought in and this amount keeps growing.

So you can't say that there is a fixed limit to it. But even if we postulate a limit, I think that limit is fairly large. I would hesitate to guess, but I would certainly say there were several billions of dollars that are susceptible to that sort of influence, very readily susceptible to it.

The problem is that if the outflow in response to interest rate differentials continues it touches off the other outflow, the speculative outflow, the loss of confidence outflow. It is a question of the relative rates between our own country and Europe. One of the advantages that has occurred recently, or in the last few months, has been declining rates of interest in Europe as they saw that their excessively high rates were causing international imbalance and also not doing the job that they wanted to do at home.

For instance, in Germany, when they put the rate up to 5 percent it was to restrict investments. They didn't restrict investments at all. It just succeeded in attracting a lot of foreign money that made the investments. So they had to reverse that.

I think this is a problem that we have to keep under advisement. But certainly the best information we have from our own sources and from foreign central bankers is that a further sharp drop in our short-term rate, say to 2 percent or lower, would initiate an additional outflow of short-term funds which would be a bad thing.

Representative REUSS. Thank you for your answer. My time is up. I asked the question solely because I wanted to be sure that we explore fully whether full employment and a stable dollar isn't the best single remedy for our balance of payments difficulties and whether we shouldn't think twice and thrice about diverting ourselves from that goal for reasons that haven't been fully analyzed. Thank you.

Chairman PATMAN. Senator Pell.

Senator PELL. Mr. Secretary, I wonder if you have any view as to the increasing boom in the stock market at the same time as the recession in our economy. Is there any correlation?

Secretary DILLON. Senator, I think the situation there is typical of previous recessions and pickups. The stock market has always moved ahead of any indicators in business. The real problem is to judge how far ahead. This movement began in the stock market last fall, in October and November, and now it has been going on for some 4 months.

I think in the recession of 1957–58 a similar movement preceded the bottom by about 4 months, and the same was true in 1948–49. In the 1953–54 decline the stock market started up some 10 months before we hit bottom. So you can't pick an exact timelag in terms of this relationship.

I would certainly think that this is a strong indicator that the investing community, looking ahead, thinks that the bottom is going to be reached pretty soon. I think that is the best I can say about it.

Senator PELL. One other question, Mr. Secretary. Have you had a chance yet to give thought as to how much reportable income is not being reported and to develop a policy for going after that income?

Secretary DILLON. This is one of the major items that we are studying and an item that might possibly be included in the tax message. There is a substantial amount of interest income that is never reported, as indicated by various studies. There is a lesser amount of dividend income that is not reported, although that situation seems to have improved slightly because of a drive initiated by the Treasury and with the cooperation of the stock exchange and corporations to educate stockholders to the fact that they should report their income.

But, certainly, the combination of the two would seem, we feel, to amount to over $3 billion of dividends and interest that is not reported and certainly we are looking very hard to see what the appropriate way of going after that is.

One of the things under consideration, of course, is the question of withholding on interest and dividends.

Senator PELL. Thank you, sir.

Chairman PATMAN. I will not take the time to interrogate you, Mr. Secretary, but I would invite your attention to some facts that I hope you will consider in your long-range planning on Government interest rates. Personally, I consider low interest rates paid on Government securities in the interest of all the people.

I invite your attention to the fact that during the 12 years from mid-1939 to mid-1951, the long-term interest rates never exceeded 2½ percent. The first 6 years of that time, that is from 1939 to the middle of 1945, that was, of course, a war emergency period. During a part of that time we were spending a quarter of a million dollars a day, and our national debt went up from about $30 billion to about $290 billion during that 6-year period.

In the last 6 years the people had plenty of money in their pockets and in the banks and plenty of credit and were seeking goods that were not available—automobiles, appliances, goods of all kinds. At that time there was one of the worst threats of ruinous inflation that any country has faced in recent times.

Nevertheless during those 12 years the interest rates on long-term Government securities did not exceed 2½ percent. And bonds that were drawing 2½ percent and less never went below par during those 12 years, not one time. That means that if the Federal Government wants to and has the cooperation of the Federal Reserve System it can be used in the interest of people to keep interest rates down. I consider that the Federal Reserve is a Government institution because it is not owned by the private banks. You agree that the private banks have no proprietary interest in the Federal Reserve; don't you?

Secretary DILLON. None whatsoever.

Chairman PATMAN. They do not have a proprietary interest in the Federal Reserve System. Therefore, they do not own it. Since it is a Government institution, it can be used in the interest of the people to keep those interest rates low if we desire to do it.

Senator Bush?

Senator BUSH. I have no further questions.

Chairman PATMAN. Senator Douglas.

Senator DOUGLAS. Mr. Secretary, I was not quite certain what your reply was to the last question of Senator Pell. Did I understand you to say that three to four billion dollars in income and interest was not reported or three or four billion dollars of tax income was not collected?

Secretary DILLON. I was referring to the reporting figure and I said it was something on the order of three to four billion dollars.

Senator DOUGLAS. Of income not reported?

Secretary DILLON. Dividends and interest not reported, between three and four billion dollars, possibly over four billion.

Senator DOUGLAS. How much over?

Secretary DILLON. The reason why I don't want to be too precise is that there is still some uncertainty about the latest figures, the 1959 figures. One set of preliminary figures for 1959 would seem to indicate that there was a very considerable decrease in the amount of dividend income unreported. However, we can't be certain that this is fully accurate until we get final figures from the Statistics of Income on the total dividends paid in 1959. Those figures in final form are not yet available. A small change in those final figures from the preliminary figures might make quite a large difference in the figure of dividends not reported.

That figure, which is, we feel, fairly firm for preceding years, showed as much as $800 or $900 million of dividends unreported in 1957 and 1958. That is dividend income alone.

The preliminary figure for 1959, on one analysis looks like that has been cut almost in half. Whether that is correct or not, we don't know. Another analysis would show almost no decrease.

Senator DOUGLAS. How about the interest payments not reported?

Secretary DILLON. The amount that is lost on interest is probably close to $3 billion of interest unrecorded.

Senator DOUGLAS. This is a smaller figure than we have been led to believe from previous reports of the Internal Revenue Bureau made to the Senate Finance Committee of which I happen to be a member. It was my understanding, although I am not able to document it at the moment, that the previous estimates ran that it was something like a total of $7 billion in dividends and interest not reported.

Secretary DILLON. The dividend figures that I gave you are the latest. I would like to have the privilege of checking the figure on interest. I am not fully certain of that figure.

Senator DOUGLAS. I would be pleased to have you submit these figures when they are available.

Senator DOUGLAS. There is one technical point that I would like to raise in connection with the recommendations which the majority of our committee made last year. We recommended that in periods when the interest rate was high, judged by long-term standards, and the Government borrowed on the basis of long-term bonds, that a callable feature be introduced in the bonds so that if the interest rate later fell that the Treasury could take advantage of the subsequent fall in the interest rate and save money to the Treasury.

This recommendation did not meet with great favor. I wonder if you have any observations about it.

Secretary DILLON. My own feeling would be that possibly it might be wise to use a callable feature on longer term bonds when interest rates are definitely high. You do pay a price for that however because the callable feature makes a bond somewhat less attractive to investors, so you will pay somewhat more in higher interest rates if you include such a callable feature.

Therefore, there is a question of judgment involved as to how much additional would have to be paid if a call feature were added, and whether the rates of interest are really high enough to make it worthwhile. But with that observation, I would say that if they were definitely on the high side it might be worth paying even a little more to have the callable feature in there for some future time.

Senator DOUGLAS. I am very glad you say that, because it seemed to me eminently sensible and I could not account for the reluctance of the Treasury to adopt the policy.

I want to congratulate you, Mr. Secretary.

Secretary DILLON. It may be that there was a difference of view as to whether interest rates were really high on a long-time basis. They may not have felt that they were. That might have been their reason.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Secretary, I want to come back to the points that I was trying to develop as far as the United States as a world trader, as a world investor, and now what strikes me has been a real problem in this liquidity picture, our position as a banker. Doesn't our problem largely revolve around maintaining a strong position as a world banker?

Secretary DILLON. I would say that is correct, yes.

Representative CURTIS. The reason I wanted to separate these various functions and, of course, they relate to each other, naturally, is we can improve our position as a banker if our trade balances are better and, likewise, if our investments are better.

Some of the proposals that have been submitted to the Ways and Means Committee in my judgment have been very good, because they relate to our position as a banker. One of them which relates solely to trade, I think, is one of the most unfortunate that I can imagine. That was recommending a reduction in tourist allowances. That isn't in the area of world banking. It is a very insignificant amount. We are talking at the most of $175 million. The one kind of trade that is most beneficial in trying to establish people-to-people relationships, of course, is our individual citizens with the individual shopkeepers of the countries abroad.

It really was a shocking thing to me to have this administration make such a recommendation and, indeed, have the State Department make such a recommendation. Inasmuch as you were in the State Department before you moved over, would you care to comment?

It seems to me this is just fundamentally unsound, to attack a problem which is essentially that of liquidity and the banker in such a picky way and one that affects our relationships of our individual citizens to people abroad so much.

Secretary DILLON. This question is one which, I think, has to be examined not only from the point of view of what the return from it will be, but also from the general position of equity. In the first place, the tourist provision has not been generally looked on by countries as an important part of trade policy as such, so that the fact that the United States has had for the last 10 years a very exceptionally high trade allowance for tourists, much higher than practically all other countries, originally put in for the primary purpose of stimulating the purchase of goods abroad by our citizens so that we could help remedy the then dollar gap, the fact that we decided to pull back a little on that has not been looked on as a basic change in trade policy.

I think that is the reason that the State Department has no objection to it. We did feel that in equity this was a type of policy that should be put into effect because we were at the same time asking our other citizens abroad, our military citizens abroad, to make certain sacrifices as part of this same program, a special allowance for military personnel to send back gift packages in the volume of $50 a day being allowed to lapse, and that figure will go back to the figure available for everybody of $10 a day.

There are certain special regulations being put in about the purchase of foreign cars and heavy equipment by service people. We thought it was only fair to spread the burden to our citizens who travel. We think they can travel and create good will without necessarily having to bring in $500 duty-free into the United States.

Representative CURTIS. I think that if we wanted to save $175 million, the top figure given, just on the basis of liquidity, we would do a lot better to cut it out in this area of Government grants rather than this one area where we certainly are having a person-to-person relationship on the basis of our citizens dealing directly with the citizens of other countries abroad. I hope somebody will start thinking that policy through a little more thoroughly. At least, it is held up for the time being and I hope it remains held up.

Now, getting back to the economy, the thing that disturbs me and disturbs me greatly about the presentation yesterday, by the Council of Economic Advisers, and which lies at the base of the administration's proposals, is the reference to a faster rate of growth.

I notice you have the words of "faster rate" in your testimony too. Of course, when we use a comparative term to make it meaningful it has to refer to the rate that you want it to be faster than. I am not exactly sure—in fact, I am thinking otherwise—but that many of the estimates of what our economic growth has been in this country by political estimators have become almost nonsense. These estimates are based upon the abuse of the good economic statistics we do have, by trying to make them serve purposes they were never intended to serve.

For instance, the gross national product is a very valuable measure, but it is essentially valuable in measuring long-term growth. If we attempt to use it to measure short term we are going to include, as we do, economic mistakes just as much as something that proves to be economically advantageous for long-term growth. But if we use it over a period of time, over a couple of decades, the economic mistakes do wash out. What rate were you thinking of when you said that we need a "faster rate?" I think our rate of growth has been amazing and most of our problems today are a result of that very rapid growth and our failure to analyze what is economic growth.

I will ask the question of you: What do you think the rate was and what do you use in estimating what our rate of growth has been?

Secretary DILLON. I think one can get into all sorts of arguments that are possibly better left for the economists when one tries to pinpoint a particular figure.

Representative CURTIS. Maybe I could illustrate by reference to Congressman Reuss' question when he was talking about lowering the interest rate. One of the areas where we have had, as many people point out, a rapid economic growth, has been in Western Europe and the result of that very rapid growth has been a great demand for investment capital.

This great demand for investment capital in turn, has increased the interest rates abroad. How can we increase our economic growth here, for example, if we don't increase the demand for investment capital and, likewise, allow the national economic consequence of raising the interest rate?

Possibly in that context you might comment.

Secretary DILLON. Yes; I think it is easy. Why I say we need a faster rate of growth is not because I pick any one particular rate, or am trying to make comparisons with earlier periods or later periods, or with other countries. Rather it seems to me that the rate of growth, whatever it has been over the last decade has been inadequate because, for one thing, our unemployment situation has been steadily deteriorating over that time.

Representative CURTIS. That will illustrate exactly what I am driving at. The unemployment statistics are large because our growth has been so rapid that we have created unusual amounts of obsolete skills. At the same time, we are gradually diminishing the demand for the unskilled laborers and the semiskilled.

So that is one of the costs or one of the problems that rapid economic growth creates. If we refer to that phenomenon as a result of a tired sluggish economy, we are apt to apply the wrong remedies to meet the problem.

It seems to me we should talk about some bare figures. Thirty percent of our plant and equipment has been estimated to be obsolete. Why? Because innovation has come in. Rapid technological changes have arrived. That is rapid growth, not sluggish growth. Thirty percent of our new products and services today, I understand, were not on the market 5 years ago.

Again, it is an indication of a rapidly growing economy, rather than a tired and sluggish one. Refer to another area, the shift of employment from manufacturing sectors to service and distributing, the shift within manufacturing from the blue collar to the white collar—all of those things seem to me to point on a very rapidly growing economy which creates problems, all right, and problems which we certainly want to direct attention to.

But do we want more economic growth in the field of agriculture, for example, where the technological advance has been so rapid that one man now can produce the food and fiber which it used to take five men to produce? That is the reason I direct attention to this area, and why I am very concerned about the administration's recommendations along a whole front of areas.

If the economy really is dynamic, and what we are experiencing is growing pains, we are going to damage this thing if we treat it as if it is a disease of old age, or a result of a tired, listless economy. I will not dwell on it because I do appreciate that this is a certain area apart from your specific field.

Secretary DILLON. I would like to comment on that.

I do not feel that our economy is necessarily tired or listless or anything like that, except that it has to do better to get rid of this increasing unemployment. I agree that some of the increasing unemployment comes from a shift in patterns, automation, things like that.

However, for our economy as a whole, the GNP figure is probably as good a measure of growth as any because it includes the whole economy. Where you undoubtedly will need increases, if our economy is going to function the way it should so that we can move ahead as rapidly as possible with new technological improvements, is in the service industries at the same time the proportion of the people employed in making things that we consume decreases with more effective tools and more effective equipment.

Therefore, one of the areas where we could do a lot better, and where I think we should—the need is there; it has been recognized by practically everyone—is in the field of education. That enters into the gross national product. That is an area where a great deal can be done.

I think the question here is that we have to move better overall so that we can absorb whatever technological unemployment has been created. One way to do this is to increase incentives, to replace old machinery, which is what we are planning to do—and we feel that is very important.

But I still feel that the economy as a whole should grow faster. That does not mean, however, that each and every segment will, and it does not necessarily mean that we have to produce more automobiles, because we may have enough automobiles.

It means the whole totality of economic activity and it may mean a shift within the totality of the economy to put more stress on the areas that have lagged. I think education is one of them.

Representative CURTIS. My time has run out, but I will return later.

Chairman PATMAN. Mr. Secretary, I will not ask many questions, but in view of your discussion with Mr. Curtis, I desire to invite your attention to a bill that I introduced that provides for one-half million dollars depreciation a year for 2 years.

The provision will expire in 2 years, for the obvious purpose of inducing the business people to take advantage of it during these 2 years. It is an antirecession measure. It is not a tax forgiveness bill. It is a tax postponement bill.

I just hope that you give that bill consideration. I hope that it will fit into your plans and serve a purpose.

I want to ask you one question and I will be thorough.

There have been some newspaper stories to this effect: that in mid-October of last year the Russians quit selling gold in the free markets of Europe, and began selling again only about 3 weeks ago, to the extent of a fourth of a billion dollars a month.

Can you tell us whether or not the Russians did quit selling gold and when this occurred?

Secretary DILLON. It is correct that the Russians' sales of gold stopped some time last fall. I cannot at this moment pinpoint it. I think it was probably during the month of October, at the time there appeared to be some loss of confidence in the dollar, and they were apparently trying to aggravate it by removing their supply from the London gold market.

As far as I know, unless it has been very recent, they have not yet resumed sales of gold abroad. There were some rumors to that effect, but we have not been able to get any confirmation that it actually has happened, although all the experts in the field of Russian trade feel they will soon have to because that is a necessary thing.

Chairman PATMAN. Thank you.

Senator Proxmire, will you preside, please?

Senator PROXMIRE (presiding). I would like to ask a few brief questions in addition to what I asked before, Mr. Secretary.

I think Congressman Curtis has given us a very useful breakdown category of U.S. investor, trader, and banker. I would like to suggest that the United States is also depending on your viewpoint, economically involved as leader of the free political world on the one hand, or as Santa Claus on the other. This definitely and drastically affects these other categories. We hope it will not be really permanent, but it is a fact of life.

I just want to clear up one little aspect of our colloquy on this before going to something else very quickly.

When you said that there had been a study which showed the balance of payments with Public Law 480 and so forth taken out, this, I presume, only corrected for the direct programs; in other words, there would be no correction for the spending of American troops abroad, for example, which would undoubtedly contribute to American exports, and perhaps would be, although I do not know, a correction for foreign grants which resulted in purchasing in America.

Secretary DILLON. There was an attempt to correct for the latter. That chart was attached to the President's balance of payments message and is available. We could give the same chart to you for the record of this committee if that would be appropriate, but there was no correction for such things as expenditures by troops abroad or things of that nature.

It was only where exports from this country were counterbalanced by economic grants and loans. We took those exports that were really not commercial exports, but were part of the gross foreign economic aid program, and took them out of the figure to obtain figures for two items, the total amount of foreign economic assistance that directly affected our balance of payments, and the total net commercial trade surplus, not counting these U.S. exports financed by our foreign economic aid programs.

This figure showed that there was some $700 million in offshore procurement under our economic foreign aid programs that affected our balance of payments last year, which is much smaller than the figure usually used.

Senator PROXMIRE. The feeling that I reflected that we may have a very basic and serious long-term problem was the discrepancy between our wages and wages abroad, and I suggested one semiprotectionism device that might be considered.

Another most encouraging development, I thought, was the German revaluation, although very small. What is it—5 percent? It is extremely limited. It seems to me that that kind of cooperation through American leadership and leadership of people abroad can help enormously to help solve this problem.

We are not going to devalue our dollar. I think that is absolutely correct. I agree with that wholeheartedly. It would be a serious mistake if we did. This kind of revaluation abroad, however, I think is most promising and I would want to encourage it.

Now I want to go on very quickly to something else.

As I understand it, the tax incentive that comes out next month will be tied to correcting loopholes so that revenue will not be lost.

Secretary DILLON. That is our objective; yes.

Senator PROXMIRE. I certainly hope you stick to that objective, because while I enthusiastically favor the incentive, I feel there is a terrible tendency on the part of Congress to agree on the incentive and tax cut and disagree on the loophole cutting and result in more fiscal irresponsibility.

You also said that there would be no overall revision—at least no major revision—of the tax structure of the kind that has been favored by the chairman of the Council of Economic Advisers, that would reduce the basic rate from 20 and 91 percent to 14 and 60 percent.

I hope that this is not a complete and total rejection of that viewpoint because I favor it very enthusiastically, and even if we could only get the upper rate down, from 91 to 65, and provide for corrections on stock options and so forth, it seems to me this would reduce a gross inequity in our tax structure and help encourage investment and would result in virtually no loss of revenue.

Secretary DILLON. Senator, I do not intend to reject that thought at all. I think that is our basic hope; that we can move in that direction. All I intended to say was that we would not have any proposals of that nature at this time, during this calendar year, during this session of the Congress, but that this was a subject which would get major attention from the Treasury and from the other departments of the Government as soon as the current work leading toward the next tax message is finished. We would hope to have developed a program along these lines for consideration early in January, by the next Congress.

But until we can get that study underway and really try to translate these objectives, which I think we all must share into concrete recommendations, it is hard to tell what the result will be. But certainly we are going to make a real effort to do it.

Senator PROXMIRE. I would like to urge on you that matter as a top priority. We have weakened our tax structure very greatly. Our tax rates are way, way out of line, and enormously unjust because they are. There are exemptions which can be justified individually, but in the aggregate shoot all kinds of holes in it. Because we already have so many we are being pressed for more, as you know.

It is going to take great resistance on the part of Congress, determination and resistance on your part as Secretary of the Treasury. I think the faster this can be pushed the better and healthier for the economy.

I would also hope you would consider the possibility of reducing the corporation income tax rate because I think that a combination of that, plus the elimination of the dividend tax credit, would result in greater equity. The incidence of the corporation income tax results in double taxation of customers and employees to the same extent that it does of stockholders.

Thank you, Mr. Secretary.

Senator Pell?

Senator PELL. I have no questions.

Senator PROXMIRE. Mr. Curtis?

Representative CURTIS. I think I can probably finish up now, Mr. Secretary. You have been very patient.

The growth rate at present in the President's report to Congress used for the previous 8 years was 2.5 percent. I might comment, by using the same techniques and using the price deflator which they did to get the 2.5—and incidentally, I set this out in a speech I gave on the floor of the House about 2 weeks ago Friday—eliminating the war years, the war economy, and taking the years 1946, 1947, 1948, 1949, which were the Truman peacetime years, we get a minus 2.5-percent growth rate.

That is unfair, but it brings out the point of what you can do when you horse around with economic statistics and do not use them for the purpose for which they were designed. I think, as a matter of fact, if we shift, as we are, from manufacturing into service and distribution, we will see a lessening of gross national product if limited just to this one economic phenomenon.

There is a multiplier effect when you invest in buildings and plant, capital plant. Certainly when we put more money into education, research, and development, those do not show up very large in the GNP of a given year, and yet the future growth depends very heavily on investment in this area.

The theory behind this administration's approach was presented to us yesterday when the President's Council of Economic Advisers referred to a gap in economic potential. I am afraid that the only way they get that is through a misuse of economic statistics. But it is very important to get this straight because they direct attention to the wrong thing.

I think you put your finger on the right thing when you referred to education, of vocational training, taking these obsolete skills and training the human beings to do the skills that are in demand.

At the same time we have this unemployment, there is not a so-called depressed area in the United States that does not have an incident of jobs going begging, where the jobs demand higher skills.

We all know we need more nurses and we need more teachers and so forth. We certainly have a tremendous job to do. I was very proud that in the last administration we tripled the amount of Federal aid to vocational education in the period of 8 years and more than doubled that in general education.

I hope we do not slow down, as this administration has suggested, by only doubling the amount of education in 10 years instead of in 8. But I dwell on this because I think this is the crux of an approach to a multitude of these problems.

There was one third area, and I will not dwell on it much, but I was surprised at your statements in regard to municipal bonds.

I asked for the HEW indicators of February 1961, which give us the amount of bonds floated in various areas, hospitals, water, sewage, education, and so forth. I must confess that the dates do not go beyond December of 1960, some of them.

But on the other hand, all of that looks very healthy. Yet you indicated that there had been a cutback. I wonder if you would recheck. I felt that this was one of the areas of strength in our economy, just as I felt that construction contracts in being in the private sector was another area of strength rather than of possible weakness.

Also, and Senator Proxmire mentioned it, in the field of corporate financing, one of the so-called loopholes is this stock dividend credit. Yet in my judgment, it has been the very backbone of financing some of this economic growth. Far from being inequitable, it is a very small effort to equalize the methods of financing between new equity and bank borrowings and retained earnings.

New equity bears a double tax, while financing through borrowings and bonds, debt financing, or retained earnings, only bears a single tax. It is exactly this kind of upside down thinking, as I call it, that in my judgment will damage the very economic growth that this administration claims that it is after. I hope we will analyze it.

So I come to my fourth point, because these two, municipal bonds for construction, corporate financing, all relate, as the others do, too, to this basic question of financing. Where is deficit financing that we anticipate for the next 2 years on the Federal level going to leave us? Is it not going to damage this whole picture?

I would like your comments as to how you think, if it is going to damage or hurt—I am not saying you are going to wreck, but it will contribute to damaging—how do you view the way out of this? Where are we going to make up this deficit?

Secretary DILLON. In the first place, the basis of my statement regarding municipal bonds was that they had not shown the usual increase that takes place when interest rates fall and the economy is in what is commonly called a recession.

That has been true through February as compared to the year preceding. The indications are that the month of March will show a rise, which I think I said, and I hope that this will continue.

Representative CURTIS. November of 1960, which is the last date on some of these, shows a very healthy period.

Secretary DILLON. There was, overall, and I do not know the reasons for it, a decrease in the first quarter and in the second quarter, a rather remarkable increase in municipal financing in the third quarter over the preceding year, followed by a rather substantial decrease in the fourth quarter.

So there was a big hump in the third quarter, all the rest of them being below the preceding year, and the year as a whole being about 5 percent shy of the year before.

On this question of Government financing of the deficit, in the first place, the deficit for this fiscal year which we are presently in is not going to be very substantial. It has been estimated somewhere upward of a billion dollars, a billion or a billion and a half dollars. It might be a litte larger.

I think that the types of deficit that we are taking about for fiscal year 1962 as probabilities largely because revenues are lower than the Government had thought they were going to be a few months ago, will not be very large, and nothing to compare with, for instance, the 1959 deficit.

So I do not think that they will pose any problem for the corporate financing and municipal financing markets because they would presumably be taken care of by an increase in total short-term Government financing.

Representative CURTIS. Do we not face quite a turnover of refinancing in 1962, early 1962?

Secretary DILLON. We face a very substantial turnover, and for that reason I think we have to use all sorts of means to extend some of the debt: that is, the debt maturing in 1962 and 1963.

Representative CURTIS. Thank you.

Senator PROXMIRE. If there are no further questions, I want to thank you, Mr. Secretary, for your testimony.

The committee will reconvene at 2:30 this afternoon in this room. We are now adjourned.

(Whereupon, at 12:40 p.m. the committee recessed, to reconvene at 2:30 p.m. the same day.)

AFTER RECESS

Chairman PATMAN. The committee will please come to order.

Mr. Martin, we are glad to have you, sir.

We will now hear from the Honorable William McChesney Martin, Jr., Chairman, Board of Governors of the Federal Reserve System.

You have a prepared statement, I believe.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, ADVISER TO THE FEDERAL RESERVE BOARD

Mr. MARTIN. I have, Mr. Chairman.

Chairman PATMAN. You may proceed in your own way, sir.

Mr. MARTIN. Thank you, sir.

Almost a year ago, in the earlier part of 1960, the Federal Reserve System began to lean against the incipient downwind of what has come increasingly to be classified as the fourth cyclical decline of the postwar era.

Already, as the winter faded, and with it the inflationary psychology that had characterized the economic situation carrying over from 1959, bank reserve positions—which govern the ability of the banking system to expand loans—had been made less dependent on borrowed funds.

Then, with the spring in progress, the Federal Reserve moved further: first, to promote still greater ease in bank reserve positions; and next, beginning in May, to provide additional reserves to induce a moderate expansion in bank credit and the money supply.

In this period in particular, new supplies of reserve funds were injected into the economy by means of open market operations. The first effect was to enable member banks to reduce appreciably their reliance on borrowed reserves. After this was accomplished the added reserves went to support the potential for bank credit expansion. In these open market operations, from late March through July, the Federal Reserve paid out about $1.3 billion, net, for the Government securities it was buying on an increasing scale. After cushioning the reserve impact of a $500 million increase of currency in circulation and gold outflow, this sum made possible a $300 million reduction in member bank borrowing and a $500 million increase in member bank reserves.

But other means available for the execution of System policy were used as well, particularly after mid-1960.

In early June, and again in August, discount rates were reduced, by one-half percentage point each time. These reductions lowered the cost of member bank borrowings from the Federal Reserve banks to 3 percent from the 4 percent level that had prevailed before.

In August also, and again in November, by actions taken in implementation of a 1959 act of Congress, nearly $2 billion previously tied up in vault cash of member banks was released to assure ample coverage of heavy borrowing needs for the fall and pre-Christmas seasons. An additional $700 million was provided by further net purchases of U.S. Government securities.

After midyear, the task of monetary policy was complicated by an outflow of gold exceeding $1.5 billion. Thus, a substantial part of the reserve funds provided by the System in this part of the year went to offset the effect of this outflow on member bank reserves.

Taking the year 1960 as a whole, the change in bank reserve positions was dramatic. From net borrowings from the Federal Reserve of $425 million in December 1959, member banks as a whole moved by December 1960 to a surplus reserve of $650 million. The total turnaround exceeded a billion dollars.

Nevertheless, the money supply showed a stubborn downtrend until mid-1960. In the spring, bank credit seemed to respond less promptly to easier reserve conditions than in comparable periods in the past. After May, however, the seasonally adjusted money supply did begin to reflect our actions. In the second half of the year, the money supply rose at an annual rate of about 1.5 percent. By year end, it had risen to $140.5 billion, just below the end-of-1959 level. The money supply has expanded further in January and February of this year. Indeed, the annual rate of increase calculated from the performance of these 2 months was in the neighborhood of 4 percent and the total money supply is now above year-ago levels.

The savings and time deposits of banks continued to grow in 1960 and after midyear the pace of growth was unusually rapid. This increase in time deposits permitted an increase of total bank loans and investments for the year as a whole by $8.4 billion. That was twice as much as the year before.

Total credit in the economy in 1960 expanded by some $37 billion. That figure was about two-fifths less than the record expansion of $61.5 billion in 1959, on which I reported to you a year ago, and more nearly in line with total credit extensions of other recent years. The smaller growth in 1960 was attributable to reduced pressure of borrowing demand, especially on the part of the Federal Government.

The most significant thing about the Federal Reserve's operations in 1960 is not that they were extraordinary but, instead, that they were typical of Federal Reserve operations under the flexible monetary policy that has been in effect now for a full decade.

That policy, as I have capsuled it before in the shortest and simplest description I have been able to devise, is one of leaning against the winds of inflation and deflation alike—and with equal vigor.

It is, in my opinion, the policy that the Federal Reserve must continue to follow if it is to contribute to the provision of conditions conducive to a productive, actively employed, growing economy with relatively stable prices.

Yet, while the necessity for adhering to that policy remains as great as ever, the difficulty of executing it has become vastly greater. This is so because of economic and financial crosswinds that have been developing for years and, since mid-1960, have been gaining in force.

The problem, it now appears, and it is by no means a problem for monetary policy alone, is to lean against crosswinds, and lean against them simultaneously. I do not know how effectively this can be done. I do know, however, that it will not be easy—just as the problems of monetary policy and of other financial policy have never been easy.

To put in perspective the problems that the Federal Reserve faces today—and how it is adapting to these problems—let me briefly review monetary policy over the past 20 years.

Immediately upon the U.S. entry into World War II in December 1941, the Board of Governors announced that the Federal Reserve was prepared—

1. "To use its powers to assure that an ample supply of funds is available at all times for the war effort; and

2. "To exert its influence toward maintaining conditions in the U.S. Government security market that are satisfactory from the standpoint of the Government's requirements."

Making good on its words, the Federal Reserve saw to it that the banking system was supplied with ample lendable reserves to provide the Government with all the war-financing funds that it could not raise through taxation and through borrowing people's savings.

It did so by buying outstanding Government securities on a huge scale. The Federal Reserve's payments for these securities wound up in bank reserves. In turn, the banking system used these additional reserves to purchase new securities that the Treasury was issuing to obtain further funds to finance the war effort.

To keep the process going, the Federal Reserve in effect maintained a standing offer to buy Government securities in unlimited amount at relatively fixed prices, set high enough to assure that their interest rates or yields would be pegged at predetermined low levels. When no one else would accept those yields and pay those prices, the Federal Reserve did so. And in so doing, it helped to finance the war.

The process was certainly successful for its emergency purpose. But the procedure of pegging Government securities at high prices and low yields entailed a price of its own that the economy—the people and the Government alike—would later have to pay. The results were twofold:

1. During wartime, money was created rapidly and continually in effect setting a time bomb for an ultimate inflationary explosion—even though the immediate inflationary consequences were held more or less in check by a system of direct controls over prices, wages, materials, manpower, and consumer goods.

2. The market for Government securities became artificial. The price risks normally borne by participants in that market were eliminated: bonds not payable for 20 years or more became the equivalent of interest-bearing cash since they could be turned into cash immediately at par value or better—at the option of the owners, at any time.

The pegging of yields and prices of Government securities was continued for some time after the war in order to provide a gradual transition to a market freely responsive to the changing demand for and supply of securities. A gradual transition was especially important because capital values generally had become moored to the artificial yields and prices in the pegged market for Government securities.

By 1950, however, the need to end the dependence of the Treasury and the Government securities market upon money creation by the Federal Reserve, and to halt the inevitable inflationary consequences, had become clear to many observers. The outbreak of hostilities in Korea and the inflationary crisis that accompanied it brought the matter to a head.

Understanding of the problem was enhanced by an exhaustive investigation conducted by a special subcommittee of the Joint Congressional Committee on the Economic Report, under the chairmanship of Senator Paul Douglas. In its report in January 1950, the congressional subcommittee said means must be found for discontinuing the pegging of the Government securities market—if financial stability and effective control over the creation of new money were to become possible in the decade of the 1950's.

After considerable negotiation, the Treasury and the Federal Reserve System reached an accord, jointly announced by them on March 4, 1951, that served to recognize and reaffirm that:

1. To serve the public welfare, Federal Reserve policy must be directed toward maintaining monetary conditions appropriate for the economy as a whole, rather than toward special treatment for the Treasury and the Government as if their interests could differ properly from those of the people as a whole.

2. Likewise to serve the public welfare, the Treasury's borrowing operations in management of the Government's debt must be reasonably calculated to induce loans to the Government in an economic system where no one can be compelled to lend his money at interest rates that he would be unwilling to accept voluntarily.

Thus, the accord reestablished the complementary operation of monetary and debt management policies by the Federal Reserve, to regulate the availability, supply, and cost of money with a view to its economic consequences; by the Treasury, to finance the Government's needs in the traditional context of a competitive market.

To provide for the gradual withdrawal of the pegs that had fixed market prices and yields, several procedures were instituted immediately and carried out over the next weeks and months.

That is much easier to say now than it was to do then. For this was the problem:

1. Hanging over the market like a storm cloud were two issues of the longest term, $2\frac{1}{2}$-percent bonds, outstanding in the total amount of $19.7 billion. Their prices had been propped around $100\frac{3}{4}$ throughout January and February 1951, by price-supporting purchases.

2. Although these bonds were not due for redemption until 1967–72, they were instantly salable in markets. In fact, many of their holders were exercising their right to sell—and selling in large amounts—so as to reinvest the proceeds in private securities yielding a higher return.

3. Even a lowering of the price props, much less a complete withdrawal, might very easily cause holders of these instantly marketable securities to unload them on the market so heavily as to cause a collapse in the market that might, in turn, provoke a sharp economic setback.

Since the primary necessity was to safeguard the market and the economy against that danger, these were the first steps taken under the accord:

Holders of the overhanging, fully marketable 2½-percent bonds of 1967–72 were offered an opportunity to exchange them, in early April 1951, for 2¾-percent bonds of 1975–80 that could not be sold at all although they could, at the holder's option, be converted into 1½-percent notes carrying sale privileges.

While the exchange was being effected, support buying was continued by the Federal Reserve and the Treasury, but at declining prices: from January through April, net purchases by the Federal Reserve totaled approximately $1.4 billion. When the exchange was completed, the offer of nonmarketable bonds had been accepted on a scale sufficient to remove from the market $13.6 billion of the overhanging marketable bonds, including $5.6 billion that had been held by the Federal Reserve and the Treasury.

This exchange paved the way for discontinuance of Federal Reserve purchases of Government bonds in support of their prices.

In May and June, net purchases by the Federal Reserve of long-term bonds dropped off to $250 million, but that was enough to assure against development of disorderly conditions in the market. After that, the Federal Reserve ceased buying almost altogether: purchases during the entire last half of 1951 totaled only $20 million. And prices, which had been supported around 100¾ at the start of the year, fluctuated around 97 during the last half of the year when the bond market was on its own.

As the years 1951 and 1952 progressed, however, market developments demonstrated a disturbing skepticism among investors that the Federal Reserve was in fact abstaining (or would continue to abstain) from attempting to maintain certain predetermined interest rates, regardless of the overall state of the demand for and the supply of savings. This skepticism was fed by market observation that the System engaged in purchases of securities involved in Treasury financings around the periods of such financings.

After very careful study of the functioning of the Government securities market and of the relation of Federal Reserve monetary operations to the market, the System decided that it would limit its open market transactions to short-term securities, usually those of the very shortest term: Treasury bills. It also decided to refrain from operations in securities involved in Treasury financings. In taking these steps, the Federal Reserve objective was to convince the market that it was not undertaking to peg interest rates—and most certainly not those on intermediate- and long-term securities.

Accordingly, to minimize market uncertainty as to possible Federal Reserve operations affecting market rates, and thereby to aid the effective competitive functioning of the market, the System announced in April 1953 that until further notice, unless disorderly conditions arose in the market, it would operate only in the short-term area, where its operations would have the least market impact.

I think I should point out here, in fairness to my colleagues on the Federal Open Market Committee, that in this decision to limit our open market operations to the short end of the market, we were not unanimous—neither then, nor since then.

Indeed, the divergence of views in the System on this question has been more marked and more continuous than on any other that I can recall in my 10 years in the Federal Reserve. That, I think, is readily understandable because the question relates to the techniques of open market operations—a highly technical and involved subject—rather than to general credit policy itself.

In my opinion, it is and always will be easier to achieve full agreement on what to do than on how to do it. To me, that explains why the uninterrupted character of the divergence in the System over operating techniques contrasts sharply with the rather high degree of agreement we have had, most of the time, over questions of general credit policy—whether and when to ease or restrain, and how much. Also, why it contrasts completely with the undeviating firmness of our opposition, at all times, to returning to a pegged market.

These matters, however, are too well known to members of this Committee for me to labor them further at this point: the records of your past hearings, as well as our annual reports, contain the views on that score of several members of the Open Market Committee, including the former and the present vice chairmen of our Committee, Messrs. Allan Sproul and Alfred Hayes of the Federal Reserve Bank of New York, as well as myself as Chairman.

In any event, following the 1953 decision I have described—the decision to confine our open market transactions to the short-term sector of the market—the emphasis in Federal Reserve operations continued to be placed upon providing bank reserves to meet the economy's needs rather than to set particular rates of interest. Inevitably, however, interest rate movements, since they reflected basic demand and supply conditions, continued to be one of many factors considered by the Federal Reserve in making judgments about the need for changes in the reserve base. Conversely, Federal Reserve operations in the market continued, inevitably, to be an important influence affecting the general level of market interest rates.

Despite confinement of its operations ordinarily to the short-term area, the Federal Reserve stood prepared to buy securities other than Treasury bills should unusual developments create disorderly conditions in the Government securities market and thus in credit markets as a whole. When disorderly conditions seriously threatened as in late November of 1955 or actually developed as in the summer of 1958, the Federal Reserve bought longer term securities to maintain or reestablish orderly trading. Apart from these exceptional and infrequent circumstances, however, the Federal Reserve maintained its reliance upon operations in Treasury bills without interruption until 1960. With the introduction of the 6-month Treasury bill in

1958 and the 12-month Treasury bill in 1959, the System extended the maturity range of its operations within the short-term area.

Toward the close of 1959 there were increasing indications, signaled by rapid rises in market interest rates accompanying a mounting intensity of borrowing demands, that conditions bordering on the disorderly might be encountered increasingly in the future and that there might be more occasions than in the past for corrective operations by the Federal Reserve in maturities beyond the range of Treasury bills.

After the middle of 1960, another consideration pointing to a possible need for Federal Reserve operations in longer term securities arose from the convergence of two important developments:

1. On the domestic front, a decline in key sectors of business activity, accompanied by gradual rise in unemployment, suggested that the economy might be moving downward on a broad pattern of recession.

2. In the area of international financial accounts, a big deficit in the U.S. balance of payments was made larger by a substantial outflow of short-term funds from the United States to foreign money centers, partly in response to higher interest rates abroad.

As I stated earlier, the Federal Reserve had been making bank reserves available to ease the credit situation since the winter of 1960. Thus, it had been a contributing influence in the decline in market interest rates to mid-1960. In the light of the domestic business and employment situation and the balance of international payments deficit, this decline presented us with a dilemma in the latter part of 1960.

If the Federal Reserve continued to supply reserves by buying only Treasury bills, the direct impact of its purchases might drive the rate on those securities so low as to encourage a further outflow of funds to foreign markets and thus aggravate the already serious balance of payments deficit.

If, on the other hand, the Federal Reserve refrained from further action to supply funds for bank reserves because of the balance-of-payments situation, it would be unable to make its maximum contribution toward counteracting decline in domestic economic activity through the stimulative influence of credit ease.

Thus, in an effort to expand reserves and yet to minimize the repercussions on the balance of payments, the Federal Reserve began, in later October 1960, to provide some of the additional reserves needed by buying certificates, notes, and bonds maturing within 15 months. Since that time, the System has bought and sold such securities, in addition to bills, on a number of occasions, duly reporting these portfolio changes in a public statement issued every Thursday.

Now at this point let me note something about the decline in interest rates that took place in 1960. During the first 8 months, market rates on Treasury bills and intermediate-term issues fell much more sharply than on bonds. This is usual in a period of declining rates.

After late summer, however, the differential between short- and long-term rates ceased to widen, and the average level of rates itself remained relatively unchanged. The increased net outflow of domestic and foreign capital from the United States in the second half of the year, in response partly to the attraction of higher interest rates and potential capital gains abroad, was itself a factor in keeping interest rates in the United States from declining, because it reduced the supply of funds available here.

It was in the latter part of 1960, as I have noted, that Federal Reserve operations were directed more and more toward reducing the direct impact on Treasury bill yields of Federal Reserve purchases. Thus, when the System was providing for the large seasonal expansion in credit needs that occurs in the fall and pre-Christmas seasons, it did not rely solely on further open market purchases but took actions that made vault cash holdings of banks fully available for meeting reserve requirements. And on the occasions when the System did engage in open market operations, it often conducted these operations in short-term Government securities other than Treasury bills.

With the domestic economy and the balance of payments continuing to pose conflicting problems, open market transactions in securities other than Treasury bills are continuing. Beginning on February 20, as we stated in an announcement issued on that date, a copy of which is attached to this statement, the Federal Reserve has engaged in purchases of securities having maturities beyond the short-term area, putting to practical test some matters on which it has been possible in recent years only to theorize.

There is still a question as to the possibility of bringing about a meaningful decline in longer term rates through purchases of longer term securities without, at the same time, causing a shift in market demand toward short-term securities that would also press down levels of short-term rates.

On the other hand, it seems to me, few could question the desirability of the result, if it can be attained, as a means of keeping financial incentives attuned to the current needs of our domestic economy and our international financial position.

We will want to observe closely, of course, the effect of this change in operating techniques on the market and its capacity to fulfill its role in transferring a large volume of securities among our various financial institutions so as to facilitate their responses to shifts in the supply of savings and the demands of borrowers.

In our country, the Government cannot force anyone to lend his money at rates he is unwilling to accept—any more than it can force him to spend his money at prices he is unwilling to pay. In the securities market, investors always have the alternative of investing their funds in short-term securities if they feel that yields in the longer term area are unfavorable. Therefore, in the outcome of this test much will depend on the reactions of investors.

As I have said many times in the past, before this committee and others, I am in favor of interest rates being as low as possible without stimulating inflation, because low rates can help to foster capital expenditures that, in turn, promote economic growth.

Yet, as I assume we can all agree, interest rates cannot go to and long remain below the point at which they will attract a sufficient volume of voluntary saving to finance current investment at a relatively stable price level. At least we can agree, I think, that interest rates cannot be driven and long held below that point without resort to outright creation of money on such a scale as to invite inflation, serious social inequity, severe economic setback, and, under present conditions, an outflow of funds to other countries and consequent drains on this country's gold reserves.

I do not believe anyone expects the Federal Reserve to engage in operations that will promote a resurgence of inflation in the future. In combating inflation in the past, undue reliance has perhaps been placed on monetary policy. I can readily agree with those who would have fiscal policy, with all of its powerful force, carry a greater responsiblity for combating inflation, and I am encouraged to think that this may be likely in the future. If we do this, we should more nearly achieve our overall stabilization goals, along with some reduction in the range of interest rate fluctuation.

That, however, is a matter for another day. Today, we have in this country a serious problem to contend with in the erratic but persistent rise in unemployment that has taken place since mid-1960. In January, the seasonally adjusted rate of unemployment was 6.6 percent of the labor force, the highest percentage since 1958; the actual number of persons unemployed was 5.4 million, the highest number since the days before World War II. I might say, parenthetically, new figures are coming out this afternoon on this.

The contracyclical operations that the Federal Reserve is and has been conducting, despite the handicaps imposed by the balance of international payments difficulties that we hope will be overcome, should be helpful, as they have been in the past, in combating that part of unemployment caused by general economic decline. Certainly, those of us in the Federal Reserve mean them to be.

While the unemployment that arises from cyclical causes should prove only temporary, there are, however, forces at work that have produced another, structural type of unemployment that is worse, in that it already has proved to be indefinitely persistent—even in periods of unprecedented general prosperity.

The problem of structural unemployment is manifest in the higher total of those left unemployed after each wave of the three most recent business cycles, and in the idleness of many West Virginia coal miners, eastern and midwestern steel and auto workers, west coast aircraft workers, and like groups, in good times as well as bad.

To have important effect, attempts to reduce structural unemployment by massive monetary and fiscal stimulation of overall demands probably would have to be carried to such lengths as to create serious new problems of inflationary character—at a time when consumer prices already are at a record high.

Actions effective against structural unemployment and free of harmful effects therefore need to be specific actions that take into account the who, the where, and the why of unemployment, and, accordingly, go to the core of the particular problem.

Analysis of current unemployment shows that, in brief:

1. The lines of work in which job opportunities have been declining most pronouncedly for some years are farming, mining, transportation, and the blue-collar crafts and trades in manufacturing industries.

2. The workers hardest hit have been the semiskilled and the unskilled (along with inexperienced youths newly entering the labor market). These workers have accounted for a significant part of the increase in the level and duration of unemployment. Among white-

collar groups, employment has continued to increase and unemployment has shown little change even in times of cyclical downturn.

3. The areas hardest hit have been, primarily, individual areas dependent upon a single industry, and cities in which such industries as autos, steel, and electrical equipment were heavily concentrated.

Actions best suited to helping these groups would appear to include more training and retraining to develop skills needed in expanding industries; provision of more and better information about job opportunities for various skills in various local labor markets; tax programs to stimulate investment that will expand work opportunities; revision of pension and benefit plans to eliminate penalties on employees moving to new jobs; reduction of impediments to entry into jobs, and so on. Measures to alleviate distress and hardship are, of course, imperative at all times.

In some of the instances cited, the primary obligation of the Government will be leadership, rather than action, for obviously a major responsibility and role in efforts to overcome unemployment, both cyclical and structural, rests upon management and labor.

For our part, we in the Federal Reserve intend to do our share in combating the cyclical causes of unemployment, as effectively as we can, and in fostering the financial conditions favorable to growth in new job opportunities.

Meanwhile, there is, I think, need on the part of all of us to recognize that the world in which we live today is not only a world that has changed greatly in recent years, but also a world that even now is in a period of further transition.

In economics and finance, no less than in other relationships, the lives of nations and peoples throughout the earth have been made more closely interlinked by developments that have progressed since the beginning of World War II—interlinked at such speed, in fact, as to outstrip recognition.

Today, the condition of our export trade, from which a very large number of Americans derive their livelihood, depends not only upon keeping competitive the costs and prices of the goods we produce for sale abroad, but also upon the prosperity or lack of it in the countries that want to buy our goods.

Whether our Government's budget is balanced or not, a factor that greatly affects our economic and financial condition, depends not only upon our own decisions respecting expenditures and taxes, but also upon decisions by governments abroad as to how far they will share the costs of mutual defense and of programs to aid underdeveloped nations of the world. The decisions those governments make affect, in turn, their budget positions and, through them, economic and financial conditions in their own countries.

Every country, of course, will always have problems of its own that differ from the current problems of other lands. Communist Russia, for example, gives some signs of worry over a problem old and familiar to us and to them: The danger of economically destructive inflation. The New York Times of January 30 reported that Premier Khrushchev, in a recent public speech had pointed to precisely that danger, noting that "the purchasing power in the hands of the Soviet people might exceed the value of the goods available for them to buy."

In Brazil, a new administration is seeking means to cope with an inflation that already has exacted an enormous price in suffering inflicted upon her people by soaring increases in the cost of living.

In Belgium, a program of austerity, to bring about adjustments made necessary by the loss of the Congo, provoked riots that recently made headlines across the United States.

In the free world, the United States has not been alone in finding that its domestic situation and balance-of-payments position seemed to call for conflicting actions, thus presenting monetary and fiscal policymakers some complicating crosscurrents.

On January 19, for example, the German Federal Bank reduced its equivalent of our discount rate and made known at the time that it was doing so, despite the high level of activity in the German economy, for the purpose of reducing a heavy and troublesome inflow of funds from other countries. A month earlier the Bank of England had reduced its bank rate also, to curb a short-term capital inflow.

Over the last weekend, Germany and the Netherlands upvalued their currencies by nearly 5 percent; these actions should help them to reduce the inflow of volatile capital.

The truth of it is that the major countries of the Western World, after a long and painful struggle in the wake of World War II to restore convertibility of their currencies, and thus to lay the necessary basis for interchanges that can enhance the prosperity of all, have succeeded—only to find that success, too, brings its problems.

Today, though currency convertibility does in fact make possible an expanding volume of mutually profitable interchanges among nations, it also makes possible dangerously large flows of volatile funds among the nations concerned—flows on a scale that could shake confidence in even the strongest currencies, and cause internal difficulties in even the strongest economies.

To the causes of these flows—differences in interest rates, conditions of monetary ease or tightness, budgetary conditions, and developments of any kind that raise questions and doubts about determination to preserve the value of a country's currency—we must remain alert and ready, willing and able to meet whatever challenge arises.

I, for one, am confident that we will meet such challenges as may come. Our opportunities for the future are more important than the problems they bring with them. Let us seize these opportunities, firmly and without fear.

That completes my prepared statement.

For the information of your committee, I am including with my statement a copy of the press release we issued on February 20 regarding Federal Reserve transactions in U.S. Government notes and bonds:

The system open market account is purchasing in the open market U.S. Government notes and bonds of varying maturities, some of which will exceed 5 years.

Price quotations and offerings are being requested of all primary dealers in U.S. Government securities. Determination as to which offerings to purchase is being governed by the prices that appear most advantageous, i.e., the lowest prices. Net amounts of all transactions for system account will be shown as usual in the condition statements issued every Thursday.

During recent years transactions for the system account, except in correction of disorderly markets, have been made in short-term U.S. Government securities. Authority for transactions in securities of longer maturity has been granted by

the Open Market Committee of the Federal Reserve System in the light of conditions that have developed in the domestic economy and in the U.S. balance of payments with other countries.

Chairman PATMAN. Thank you, Chairman Martin.

First, I would like to ask you when your annual report for 1960 will be available?

Mr. MARTIN. I think within the next week or so, Mr. Patman.

Chairman PATMAN. I notice in the past you have filed the report with the Speaker of the House rather early in the year, but for some unknown reason the copies were not available to Members of Congress until 2 or 3 or more months later. Could that be corrected some way so that when the report is filed with the Speaker of the House copies will be made available immediately to Members of the Congress?

Mr. MARTIN. I was unaware that that was the case, Mr. Patman.

Chairman PATMAN. That is the way it has been. I looked into it because I was disappointed in the unusual delay in receiving copies for the preceding year.

Mr. MARTIN. I will see that everybody gets them just as at the same time we file it with the Speaker I will see it is filed with all the members of the committee.

Chairman PATMAN. That will be fine.

Mr. Martin, evidently from the actions of the Federal Reserve Board and the Open Market Committee, in particular, in recent months, there have been many changes of policy. You have become somewhat flexible. Is that by reason of some understanding or agreement with the Treasury?

Mr. MARTIN. No, Mr. Patman. We took this decision on our own. Of course, we had consultations with the Treasury as we have always had consultations with the Treasury.

Chairman PATMAN. You did have some understanding or something like that each one knew what the other was going to do, I assume.

Mr. MARTIN. We have constant consultation with the Treasury, yes, sir.

Chairman PATMAN. Would I be correct in assuming that you have reached a new accord with the Treasury?

Mr. MARTIN. No, I would not say so, Mr. Patman. I would say that the techniques which we are following are slightly different from the techniques that we followed before. But I do not think that there is any new accord in that sense.

Chairman PATMAN. If I refer to it as a so-called accord, is the President of the United States a party to that understanding as to what you are going to do?

Mr. MARTIN. No, Mr. Patman. Mr. Patman, I have consulted with the President of the United States, but there was no pressure placed on me to do anything.

Chairman PATMAN. I am sure that there was not. Anyway you have become pretty flexible in considering your actions in the past.

Mr. MARTIN. Mr. Patman, as I have said to you a number of times, good naturedly, flexibility is a matter of definition.

Chairman PATMAN. Yes, sir.

Mr. MARTIN. I do not think I have changed any.

Chairman PATMAN. The so-called accord in 1951, between the Treasury and the Federal Reserve. Was the President of the United States a part of that accord?

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Mr. MARTIN. In 1951?

Chairman PATMAN. Yes, sir.

Mr. MARTIN. He was apprised of it.

Chairman PATMAN. I mean was he a party to it?

Mr. MARTIN. I do not think you could say he was a party to it.

Chairman PATMAN. Did he denounce it?

Mr. MARTIN. It was announced by——

Chairman PATMAN. I said did he denounce it, not announce, but denounce.

Mr. MARTIN. He didn't do either one, to my knowledge.

Chairman PATMAN. I thought when he had all of you over at the White House——

Mr. MARTIN. Mr. Patman, let us get the record straight on that. I was Assistant Secretary of the Treasury at the time. I was not over at the White House.

Chairman PATMAN. But you were more than that. The Secretary of the Treasury was in the hospital, and you were acting for him.

Mr. MARTIN. I kept in very close touch with him, Mr. Patman. I kept in very close touch with him.

Chairman PATMAN. I know you kept in close touch. But you did not do exactly what he wanted every time. You got a little ahead of him, did you not?

Mr. MARTIN. No, Mr. Patman. I did not get ahead of him. We worked under some difficulties during that period, but he was kept in close touch with things. I went out to the hospital and reported to him on all the moves and had his authority to go over to the Federal Reserve Board and negotiate.

Chairman PATMAN. It is a correct statement that the President of the United States was not a party to it, is it not?

Mr. MARTIN. In 1951?

Chairman PATMAN. Yes, sir. Mr. Truman?

Mr. MARTIN. No, Mr. Patman, that is not correct.

Chairman PATMAN. I cannot understand why you would say that when he denounced it and when he denounced the members for not carrying out his instructions to protect the bond market?

Mr. MARTIN. You are talking about preaccord and postaccord.

Chairman PATMAN. Let us get it on preaccord, accord, and postaccord.

Mr. MARTIN. All right. Let us try to get it in sequence. I was not a party in any way to the meeting of the Open Market Committee at the White House; I was an Assistant Secretary of the Treasury.

Chairman PATMAN. But you knew what happened?

Mr. MARTIN. It was reported to me what had happened, through the then-Secretary of the Treasury, but it occurred before the Treasury-Federal Reserve accord, and it was one of the reasons for the Treasury-Federal Reserve accord which I have tried to spell out here in detail.

Chairman PATMAN. After that you knew that Mr. Truman did not approve of it because he used language that we cannot use here.

Mr. MARTIN. You have records that are not available to me. I did not hear him use any language, so that as far as I know everything was all right.

Chairman PATMAN. Anyway, Mr. Martin, the President of the United States fixes interest on Government bonds, does he not?

Mr. MARTIN. Yes, he has the final authority with the Treasury.

Chairman PATMAN. That is his authority. He has the final authority?

Mr. MARTIN. Yes, sir.

Chairman PATMAN. Would he not be a necessary party to any accord? Would you not be rather presumptious acting for the Treasury to agree with the Federal Reserve on something that involved the President of the United States on such a vital matter as fixing interest on Government bonds and never consult him and never get his permission?

Mr. MARTIN. Far be it from the Federal Reserve to be presumptuous at any time, Mr. Patman, as you well know.

Chairman PATMAN. I am talking about you as Acting Secretary of the Treasury.

Mr. MARTIN. As I have tried to make clear in my statement, the traditional context within which the market operates requires the Treasury, in setting coupon rates and in pricing securities, to recognize that people cannot be forced to buy its securities.

Chairman PATMAN. Let us do not get off this subject.

Mr. MARTIN. This is the subject.

Chairman PATMAN. The President of the United States fixes the interest on Government bonds. He has the last say. Here you are acting for the Secretary of the Treasury dealing with the Federal Reserve not consulting the President of the United States who has the final say agreeing on an accord and you call that an accord.

Mr. MARTIN. No, Mr. Patman. The process is that the Treasury has to consult with the President to get his authority when they make a decision. But, in my humble judgment, neither the President nor the Treasury nor the Federal Reserve could set a coupon rate and price that is apart from the market.

Chairman PATMAN. My time has expired, but the Federal Reserve did successfully secede from the Government and become a fourth branch of the Government in that instance.

Mr. MARTIN. No, sir.

Chairman PATMAN. I do not think you are going to get by with it.

Mr. MARTIN. No, sir, Mr. Patman; that I deny.

Chairman PATMAN. Senator Bush.

Senator BUSH. Mr. Chairman, would you tell us, Mr. Martin, do you anticipate the open market operations will get into the longest term Treasury bonds within the near future?

Mr. MARTIN. I do not know, Senator. We have to feel our way along, and take action in accordance with a judgment that has to be made by the manager of the open market account; that is the decision that was made. I might say that we made the public statement that we did at the very time that we were making some transactions in the market. We did this so that no one could have any advance indication of what was happening either by conjecture or otherwise. The statement was made as simple and as general as possible so as not to commit us to any specific maturity range. All we said was that maturities of some purchases would exceed 5 years.

Senator BUSH. There has been some easing in the longer term market in the last few months, has there not?

Mr. MARTIN. Yes, sir, there has, and that has been caused partly by open-mouth operations, as we might call them, and partly perhaps by some of the Federal Reserve activity, but how far that will go or what the implications of it are we will have to await development.

Senator BUSH. But your move into the longer term securities has been in the face of an already slightly declining market?

Mr. MARTIN. That is correct.

Senator BUSH. Is that not true?

Mr. MARTIN. That is correct.

Senator BUSH. As you keep on easing that market are you not somewhat apprehensive of running into the short-term market where efforts seem to be made to bolster it up as far as yields are concerned?

Mr. MARTIN. That is the problem that I tried to pose in this statement as to how far you can go in a constructive way to achieve a result. Now, we all recognize that arbitrage works at times in the market. How fast it may move or how actively it may move is a matter of judgment, but certainly what the Federal Reserve is trying to do here is to accept some leadership responsibility, recognizing that we cannot control or make interest rates, but that we can try to lead toward these two contradictory goals, and I think——

Senator BUSH. What are you doing to try to help keep the short-term interest rate up?

Mr. MARTIN. Well, the mere fact that we do not purchase as actively in the short-term interest rate——

Senator BUSH. Staying out?

Mr. MARTIN. Yes—at that point removes some pressure from that market. Now, as purchases are made in the intermediate or longer areas of the market, reserves are supplied to the market and we have no control over how they will be used. Nevertheless, we do think that the leadership that we are trying to exercise can be constructive.

Senator BUSH. I think the committee certainly is very grateful for a very thorough review of the monetary policy here in the last 20 years. This will be a very useful thing for us to have. I must say for myself that I am somewhat confused by the recent action of the Fed, and by the conflicting efforts to ease money in the longer term category and firm it up in the shorter term category. I can appreciate the need for holding funds in this country that may be attracted overseas by higher interest rates. But I am very much afraid that we have an awfully difficult situation facing us to squeeze down the spread between long- and short-term interest rates, and that this may be self-defeating in the end because if insurance companies and pension funds and investors of that kind can see a high enough yield in the short market they will go in there and wait until they can get a better yield than the long market. It seems to me I have seen that happen many times in practical investment circles. I simply express some apprehension about this business of making water run up and down hill at the same time.

Representative CURTIS. Will the gentleman yield?

Senator BUSH. I yield.

Representative CURTIS. I thought that Mr. Martin's figure of speech gave a pretty good picture, leaning against crosswinds—simultaneously. I was trying to figure out how one could be in such a position.

Mr. MARTIN. Well, I tried to state as clearly as I could what we are really trying to do. There has to be a possibility that we may have some success at it. How much, I do not know.

Senator BUSH. I am finished, Mr. Chairman.

Senator DOUGLAS. Mr. Martin, I would like to give a minor note, if I may.

Mr. MARTIN. Certainly, sir.

Senator DOUGLAS. When the Joint Economic Committee was conducting its study in employment growth and price levels, we had a colloquy at the end of one of the sessions in which, as I remember it, I urged that we collect figures on the Government securities market. We probed that later in the year, and it developed that here was a market where the annual volume amounted to $175 and $200 billion, that virtually nothing was known about the market, that the margins were narrow, and there had been an unfortunate experience of the preceding year, 1958, and I expressed the hope that the Federal Reserve at least as a first step gather statistics on the market. Then the Joint Economic Committee followed this up with a special study conducted by some economist from Pittsburgh. I think they did a very good job.

Last week I addressed a letter to you under date of March 2, in which I said:

> The lapse of a year and a half has not diminished my interest in this problem or eroded my belief that the establishment of a reporting system in the market and of Federal Government securities is essential to the success of both monetary and debt management policies. I hope it will be possible for this program to soon be put into operation.

I wonder if you are willing to report on what progress, if any, has been made in the field of reporting Government securities.

Mr. MARTIN. I will be very glad to, Senator. First, let me say that I second your comment with respect to the study that was made by the two economists for the Joint Economic Committee. I think it is a very useful and constructive study. I would not agree with everything in it, but it is a splendid study, and they point out in that study that the dollar volume of securities traded, Government securities, is five times, I think, the volume on the New York Stock Exchange, the dollar volume. I think that alone underscores the point that you are making—that we ought to have more information and statistics in this.

Now, Mr. Young, who is with me, chairmaned a group to work with the Treasury, and our people on this, and I think we have made progress. We are hoping to make some announcements and be ready to go on a regular basis within the next 30 days or so. I wonder if you would like Mr. Young who has been working on this to make a comment on it.

Senator DOUGLAS. Very glad to have you do that, Mr. Young.

Mr. YOUNG. We have been working, Senator, with the dealers, consulting with them, and also testing out various kinds of information that they have provided to us, and we are developing a program that will include regular reporting of information on closing price quotations, daily average figures on the volume of transactions by maturity of class of obligation, and daily average figures on dealer positions and on dealer financing. There will be a little timelag in making these latter figures public, but they will be reported as promptly as is feasible.

Senator DOUGLAS. Do you disagree with the dealers, Mr. Young?

Mr. YOUNG. We have worked closely with the dealers. We are not sure they all agree with us, but we think that the program we have worked out will be acceptable to them and that they will cooperate with us in it.

Senator DOUGLAS. They have not formally accepted it, though, as of this moment?

Mr. YOUNG. We have not yet formally requested their cooperation. Only this morning did we get an approval for the program from the Federal Open Market Committee. We are going to go forward immediately in launching the program and hope to get it activated by the 1st of April.

Senator DOUGLAS. Thank you very much.

I think this is an illustration of the way in which this committee and the Federal Reserve and Treasury and private dealers can work together cooperatively, and I think that the information which we obtain ought to enable us to begin to understand, at least, one of the most important and one of the most murky of financial problems. I want to thank you and congratulate Mr. Martin.

Mr. MARTIN. I think we are making real progress, Senator.

Senator DOUGLAS. I have time only to pose a series of propositions, and I do not want to have you answer them at this moment, but perhaps you will be ready in the next go-round of questioning.

The precise recommendations of the majority of the Economic Committee last year were very imperfectly understood by the public, by the financial press and the rest, but in dealing with Federal Reserve policy we made basically a series of very simple recommendations.

First, that there be a secular increase in the availability of the money supply, that is, demand deposits, at somewhere around the rate of increase in the real gross national product or, if you want to pin it to a precise figure, somewhere around 3 percent a year.

Second, that this increase be affected primarily by open market operations, that is, the purchase of Government securities in the open market by the Reserve, rather than by a further reduction in the Reserve ratio of the member banks. We pointed out that with a 3-percent increase this would mean roughly a purchase of around $600 million worth of Government securities each year for the Federal Reserve. It would permit a credit expansion of around $3.6 billion, and in this way the Government will get one-sixth of the increase in monetary purchasing power instead of having all of the amount go to the private bankers as would be the case in lowering reserve ratios. This was our second recommendation.

We pointed out the huge sums that this would amount to over 15 or 20 years, running to many billions of dollars.

The third recommendation was that this was to be effective primarily by the purchase of long-term bonds, rather than merely by bills only.

These were my recommendations which seemed to us eminently sensible but bitterly criticized by certain members of the committee, bitterly criticized by sections of the financial press. But I wondered if you would think this over and on the next go-round you would be willing to state whether you now agree with any of these contentions, or whether you disagree.

I will now pass.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. I did not recall a bit of criticism on that part. We certainly had some bitter criticism on other aspects of the majority report.

First, I want to say how much I appreciated your statement in spite of the remark I made about your figure of speech of simultaneously leaning against the crosswinds. I did think I understand or feel I understand what you are driving at, and I think it is a very difficult position. I am wondering whether or not we do not get a little bit oversimplification of it because of the figures of speech, particularly when we talk about short- and long-term markets. Obviously there is a great impact of one on the other, and they are not just that easily divided, are they? Would you say that could be so?

Mr. MARTIN. Yes. I think there is a problem there, but I think you have to realize that our primary responsibility, as I have always said, is to supply and absorb reserves to the economy. Now, we ought not to get ourselves into the position that this long debate has gotten us into, that merely by supplying and absorbing reserves completely absolves us of any responsibility for what happens in the cost of money—interest rates, because changes in the volume of reserves do have some influence on rates.

Now, it is further complicated, and that is what I tried to put in the statement here, by the fact that we must have complementary working with the Treasury. The calendar of Treasury financings necessarily has something to do with how you operate. Now, if the Treasury is going to issue a given security at a given time, regardless of what the market is at that particular time, it has some effect on the interest rate structure quite apart from Federal Reserve operations.

And as Senator Douglas used to say a good many years ago: Good fences make good neighbors, and we ought to know where the Treasury stands, and where the Federal Reserve stands. You may recall that I always responded to him by saying what we needed was a revolving door or gate through the fence.

Representative CURTIS. I recall your previous explanation when you were criticized on what was called the bills only policy where you pointed out there were occasions in the past where you deviated because of these objections and, at least, to me your position has been quite consistent. It is the changing times and changing circumstances which you have pointed out to us that have brought about the need for the change in approach rather than any adverse criticism that might have been directed against the policy, although criticism is always helpful to trying to understand the problem.

One other point, and I will not dwell on this other than to point it up because I want to ask a more basic question. I was very happy to have your statement, and I presume it is the result of studies in the Federal Reserve System on this problem of unemployment, particularly in light of the testimony of the President's Council of Economic Advisers yesterday, where they said that regarding this problem of long-term structural unemployment it is shown to be false and then they go on to almost deny categorically the analysis that you have presented of the unemployment picture. I must say your analysis was the same analysis that I had reached from the studies that we in this committee and in the Ways and Means Committee have made from time to time in relation to unemployment insurance and things of that nature. But I am happy about one thing. Maybe we are getting this difference of opinion out in the open, where we can actually perceive who is right and who is wrong, because we ought to be able to find out whether unemployment is of the nature as you have described or whether it is of the nature that the President's Council of Economic Advisers describe it.

The question I would like to ask, though, is whether the Federal Reserve has made a statement in regard to its position or where it is going to be in the event of the OECD Treaty being adopted.

First of all, has a statement been made, issued by the Federal Reserve on your position?

Mr. MARTIN. No; no statement has been issued by the Federal Reserve. I think that I have discussed it with Secretary Dillon on several occasions. As I understand it, the OECD setup is not to be a decisionmaking organization.

Representative CURTIS. So you do not think it will in any way adversely affect?

Mr. MARTIN. I am assured that it will not, and certainly we are all in favor of the general cooperation which is involved in it. There are obviously complications in it because different central banks have different relationships to their treasuries or ministries of finance and the economies they represent have many differences as to characteristic and fluctuations. These will be reflected in budgetary problems, fiscal and debt management problems, problems of productivity and wages, and interest rates.

Representative CURTIS. I see my time has run out. I will come back to this, if I may.

Chairman PATMAN. Senator Proxmire has to leave in just a few minutes, so we will ask Congressman Boggs if he will yield to Senator Proxmire.

Representative BOGGS. With pleasure.

Senator PROXMIRE. I thank Congressman Boggs very much.

I would like to pursue the point that Mr. Curtis alluded to very briefly.

You say, Mr. Chairman, in your statement:

> While the unemployment that arises from cyclical causes should prove only temporary, there are, however, forces at work that have produced another, structural type of unemployment that is worse, in that it already has proved to be indefinitely persistent.

And you say further:

> To have important effect, attempts to reduce structural unemployment by massive monetary and fiscal stimulation of overall demands likely would have to be carried to such lengths as to create serious new problems of inflationary character.

The Council of Economic Advisers did not just pass this off as a casual opinion. They made a very thorough and careful study. Mr. Tobin, who has a splendid reputation as an economist, studied this in great detail. He considered every possibility, that this assertion of yours could be true, and he put a question. I want to be as exact as I can on it. He says:

The question sometimes arises whether the obstinate refusal of the unemployment rate to decline below 5 percent since the end of 1957 is a consequence of long-term structural changes in the age, sex, and other composition of the labor force, and not of weakness in aggregate demand. If this were so, it would mean that measures to stimulate the general level of economic activity might fail to get the overall unemployment rate down to tolerable levels. Indeed, as the cyclical component of unemployment vanished, leaving only the hard core, the result might be inflationary wage increases.

His statement is:

But this argument can be shown to be false.

He underlines that for emphasis, and goes on for a detailed explanation and concludes with this short paragraph which summarizes his argument:

At the end of this long argument it is worth saying that it is no part of our intention to cry down structural unemployment or explain it away. The problems of younger and older workers, of nonwhite members of the labor force, of the technologically displaced, and of the distressed need to be attacked at the source. But our concern for them ought not to divert our attention from the real cause of weakness in 1961's labor market—and that is inadequate demand.

It seems to me that the Council of Economic Advisers' analysis in this very thorough study makes it clear that they feel that this structural or hard core unemployment should not be used as an alibi to prevent fiscal and monetary polices that would increase demand.

Mr. MARTIN. I am in complete agreement with that, and that is why the Federal Reserve is following an easier money policy at the present time.

I have not yet read Mr. Tobin's statement; however, I am looking forward to studying it.

Senator PROXMIRE. This brings me, then, to the principal thing I wanted to ask:

You indicated at the present time the Federal Reserve Board, as we all know, has been following an easier money policy. I know on page 9 of the economic indicators that at no time since 1953 has the unemployment rate fallen below, in any one year, at least, 4.2 percent. Four percent is the level which the Chairman of the Economic Advisers yesterday indicated was perhaps tolerable.

When unemployment was higher than that rate, the implication I received was that the Government should do all it can to adopt policies to reduce it.

Mr. MARTIN. You already know my skepticism about making any precise measurements, and the reason I wanted to put it into my statement here, about unemployment, is that I find it very difficult to know what the normal is or should be, what is a level of overemployment, let us say, or a tolerable level of employment.

I will just go through the three recent experiences.

In 1953–54 we started on 2.6 unemployment and went up.

In 1957–58, we started at 3.8 and went up.

In this cycle, we started at 4.9 in May of 1960. It may be that 4 percent is a "tolerable" rate.

But coming out of the war, I think we have to analyze very carefully the differences between cyclical and structural unemployment and do everything we can to combat both types.

That is really the point I am trying to make.

Senator PROXMIRE. What I am concerned about is the possibility that we may go to a level of say 5.5 percent unemployment. There may be many other indications in the economy, profits, income, wages, which suggest that we are in a period of prosperity. Under those circumstances, there may be a tendency for the board to follow a tighter money policy that would slow down construction and other economic activity—create more unemployment with the view that if they did not follow that policy the results might be inflationary.

Mr. MARTIN. That is the problem the Federal Reserve has to deal with.

We will read Mr. Tobin's report, and I am sure every member of the Board will read it very carefully.

But it is the overall problem we have been dealing with. I, at a point, tried to highlight the thing—and I do not want to make a speech to highlight the thing that what we are trying to deal with here is the relationship of fiscal policy, debt management policy, budgetary policy and the wage-cost problem.

All of them have a relationship.

I would like to see—I keep testifying to this over and over again, and I am not trying to belabor it—I personally would like to see as low interest rates as we can have without producing inflation.

But I do think that inflation is far more disastrous than some people seem to think in terms of even a little let up.

Senator PROXMIRE. I agree with you wholeheartedly. I am certainly strongly against inflation, also. I question, however, whether monetary policy high interest rates is a very effective weapon to oppose it. We just don't know. We do know it increases unemployment. This is sure and definite.

I just have one final question:

It would seem to me that although the Board has been following an easy money policy, the fact is, as you have pointed out, that the supply of money has increased relatively modestly since June. That is from $139.4 billion to $141 billion, and the ratio of the supply of money to the gross national product has increased 27.8 percent to 28.2 percent.

It seems to me this is a relevant relationship. The relationship of the money supply to the gross national product measures the tightness of money.

The fact is that money is still tighter than it has been any time in 30 years, and much tighter.

You have to go all the way back to the 1920's to find a situation where we had such tight money.

That is why I would ask you if you do not feel that the Federal Reserve Board has a long way to go before it moves into a position where we can say that our monetary policy is in fact a positive encouragement for construction activities and economic expansion generally.

Mr. MARTIN. My answer to that is that I don't know. But I want to try to put this money stream in the perspective that I have, which is that we have been moving for a long time.

In the 1957–58 recession, which I testified to, about the only thing it seems to me that came down at that time was money rates.

We went down to a half of 1 percent in the bill rate. The Federal was quite aggressive in our monetary policy, and in the early part of 1958 we were having an increase in the money supply of about 8 percent.

We quickly got a recovery, that we now hear characterized as an anemic recovery.

I have some question about that phrase, but we got a recovery very dramatically.

We got a budget deficit, and we came upon a period where the balance of payments problem became equally as difficult as the domestic recession.

Where you start on this money supply is what has bothered us all the time. During the war, as I have tried to point out in the statement, historically, we got a time bomb into this picture. We can have varying judgments as to whether that time bomb has been entirely spent or not.

I have felt that the time bomb has been lingering with us and that we have not really "solved" this problem of the overall money supply.

Let me just add here again that in the 1959–60 period you began to see changes in what constitutes the money supply, particularly in bank demand deposits or checking accounts.

My favorite illustration of this has been that I know one eleemosynary institution in Washington, and you can multiply this by the thousands, that had never bought bills in its life; that even though it had a very small balance, was not leaving that balance with the bank, but was buying bills with it.

Do you see what that does to your components?

I tried to point out here that we were actively expanding the money supply, but there was a stubborn resistance to our expansion. There are many factors in that, but in the process the banks got themselves less liquid—I don't know what the proper loan deposit ratio is, but it kept going higher and higher.

Then when business began to decline, the banks being the same as the rest of us began to look at the business picture and they started to become more liquid, whereas if business were going high, wide and handsome, they would not have hesitated to have that ratio move up from 70 percent to 80 percent.

Now, there comes some point at which you are endangering everybody on a ratio of that sort.

What I have frequently said, and I don't mean to say this for effect, but I live with the money supply, our staff lives with the money supply, and I find it very difficult to know what the components of really it are and how they will change.

I think all of us have to study a great deal more before we can say positively and precisely that this is what constitutes the money supply.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator DOUGLAS. Congressman Kilburn.

Representative KILBURN. Mr. Martin, I thought your statement was an excellent one. In your interchange with Mr. Patman, there was one thing that you said that I would like to get a little clearer.

As I remember it, you said that the Federal Reserve and the Treasury set the interest rates on bonds, but the President has the final say so.

Mr. MARTIN. Under the law, Mr. Kilburn, the Treasury has to get the approval of the President before it can issue any security. That is the law as presently constituted.

Representative KILBURN. Then I thought you added this: that neither the President or the Federal or the Treasury can really set the interest rates. Is it not the law of supply and demand?

Mr. MARTIN. That is certainly my point of view, that it is not possible for any length of time—you may do it for a limited period of time—it is not possible in an economy as strong, as vigorous, and as active as this economy for any of us to set a fixed rate of interest and hold it there against the law of supply and demand.

Representative KILBURN. I have been hearing talk around here for years that some sinister influence, the big bankers or the President or somebody, was setting the interest rates and I never believed it.

I still think they are set by the law of supply and demand. Maybe I am wrong.

I am a little country boy, so I do not know. I am glad you agree with me.

That is all, Mr. Chairman.

Senator DOUGLAS. Congressman Boggs.

Representative BOGGS. Mr. Martin, in connection with that line of examination, I recall you with our mutually good friend former Secretary Anderson, spent quite a few days before the Ways and Means Committee on proposals to introduce legislation.

My recollection is that those proposals were not adopted; is that correct?

Mr. MARTIN. You are talking about the 4¼ percent ceiling proposals?

Representative BOGGS. Yes, in 1960.

Mr. MARTIN. No, they were not adopted.

Representative BOGGS. At that time, it seems to me, and I could be wrong, you were rather strongly for it, were you not?

Mr. MARTIN. I was for them then, and I am still for them, Mr. Boggs.

Representative BOGGS. You still recommend that legislative program?

Mr. MARTIN. I certainly would. It is not a matter of importance at the moment in the level of interest rates, but I think it is very desirable and I might say even essential that that legislation go through.

I hope we are going to be prosperous enough in this country so we will need it.

Representative BOGGS. My further recollection was that you saw considerable inflationary prospects ahead if we failed to enact that legislation.

As a matter of fact, we entered into somewhat of a deflationary period, did we not, after that?

Mr. MARTIN. Well, that is the way it worked out. But let me point out to you that we had a terrific upset in the market, and my conviction is that we would have had lower interest rates across the board if it had not been for that ceiling.

Now that is a matter of judgment. All I can say is that we had the magic 5s and the market knew that the Treasury could not do anything, except deal in the 1 to 5 area.

The only other alternative was for the Federal Reserve to buy not just a few bonds, but all of them.

I don't think the way to sell the Federal debt is to sell it to yourself, which is what selling it to the Federal Reserve is.

When we think of how we operate on the market, I have not heard anyone propose—and you certainly did not at the time—propose that the Federal Reserve buy all the bonds.

Representative BOGGS. I am really just inquiring to find out what your position is as of now.

Mr. MARTIN. My position is the same.

Representative BOGGS. I have no further questions, Mr. Chairman.

Senator DOUGLAS. Congressman Reuss.

Representative REUSS. I, too, am impressed, Governor Martin, by the point made by Mr. Curtis and Senator Proxmire that there is a very sharp contrast in the advice given this committee by you and by the Council of Economic Advisers. The Council in its testimony yesterday on pages 15 and 16, and throughout supplement B, emphasized the fact that unemployment is more cyclical than structural. It stated that area unemployment and unemployment of older workers have not increased percentagewise in recent years, and it concluded that the problem is chiefly cyclical in character. In the words of Mr. Heller's testimony, this unemployment "must be met by action on the demand side."

As he says: "Measures to improve the mobility of labor to jobs," et cetera, "are no substitute for fiscal monetary and credit policies for economic recovery."

In your testimony today, you say on pages 16 and 17, that unemployment that arises from cyclical causes should prove only temporary. You say, however, that there are forces at work that have produced another, structural type of unemployment that is worse, and then you go on to say, at the top of page 17:

> attempts to reduce structural unemployment by massive monetary and fiscal stimulation of overall demands likely would have to be carried to such lengths as to create serious new problems of inflationary character.

Would you be good enough to review carefully the pages of the testimony that I have just called to your attention and, as a supplement to your testimony here today, file with this committee as soon as you can, a commentary on what appears to be an important conflict in your testimony and that of the Committee on Economic Advisers.

In the Council's view, there are fundamental implications for monetary and fiscal policy because the problem is essentially one of cyclical unemployment on the demand side.

Your view seems to be that while there is some cyclical unemployment the worst part of it is structural and, that therefore you cannot rely too heavily on monetary or fiscal stimulation without risking inflation.

Since this is of the essence, it seems to me that it would be well to review the two statements. If on reflection you find that there is no conflict between the two positions, please say so. But to my ear there appears to be a very basic conflict.

Would you be willing to do that?

Mr. Martin. I would be very glad to review it carefully.

Representative Reuss. Thank you.

(The information referred to follows:)

I have examined the statement of the Council of Economic Advisers before the Joint Economic Committee on March 6, 1961, relating to the current unemployment situation. It seems to me that the apparent differences with my testimony are mainly ones of definition and emphasis.

In general discussion of the unemployment problem, unemployment is customarily thought of as dividing into such categories as frictional, cyclical, and structural. Specific quantities cannot be attached to the several types, however, because unemployment at any time is the joint result of many causes and no method has been devised to separate statistically the unemployment figure into that which is frictional, that which is cyclical, or that which is structural. Judgments may and do vary among informed persons as to the relative importance of unemployment to be assigned to these categories.

In my testimony it was pointed out that the Federal Reserve is currently following a monetary policy aimed at combating unemployment arising from contraction of overall demand. The Federal Reserve is also committed to foster financial conditions favorable to economic growth and to the optimum utilization of expanding industrial and manpower resources under conditions of relatively stable prices. It is hoped that our actions, as well as those that other Government agencies have taken or propose to take, will help to reverse economic recession, reduce unemployment in all sectors, and promote sustainable expansion of the economy.

The upward drift that unemployment had shown over recent economic cycles is a matter about which I expressed special concern. I noted that, among certain groups of workers and in certain geographical areas, unemployment had remained disturbingly large, even during periods of high-level activity. Unemployment of this type is said to be structural in nature because it is associated, at least in part, with such factors as shifts in consumer demand, depletion of resources, shifts in defense activity, changes in technology, foreign competition, and relocation of plants. A major difficulty in absorbing into other gainful activity workers displaced by such developments is that their skill, education, training, and backgrounds are not generally those required in expanding activities. In addition, mobility of workers attached to declining industries is limited because they often are middle-aged or older workers with families who have deep roots in their home communities.

That persistent unemployment attributable to changes in economic structure has become a serious problem has been well documented in testimony presented by Government officials, labor leaders, and businessmen from all parts of the country before the Subcommittee on Production and Stabilization of the Senate Banking and Currency Committee. The findings of other congressional committees recently studying unemployment problems, including the House Ways and Means Committee, the Senate Special Committee on Unemployment Problems, and your own committee, substantiate the mounting import of this problem.

Although expansion of demands for almost all types of goods and services is clearly appropriate in the present economic setting, Government measures geared to specific causes of unemployment can also contribute countercyclically to employment adjustments in this setting. It was for this reason I suggested a number of possible additional measures which might open up new job opportunities and curtail the hardship and distress stemming from structural unemployment.

In calling attention to the problems of structural unemployment, it was not at all my intention to suggest priorities in terms of remedial measures. I see no inconsistency in proposing that responsible policies be pursued simultaneously, on the one hand, to stimulate the economy, reverse the downdrift in economic activity, and decrease cyclical unemployment, and, on the other hand, to alleviate unemployment resulting from structural changes. Indeed, I believe that we should pursue both courses of action.

Certain forms of unemployment, as I tried to make clear in my statement, are not readily responsive to overall monetary and fiscal measures. Where causes of unemployment are due to special factors such as immobility of labor or inappropriate skills of workers, massive applications of monetary or fiscal stimulants after recovery is well under way could produce inflationary pressures without solving the more selective unemployment problems. Accordingly, it has seemed important to me that certain measures to assist those who suffer hardship because of dynamic structural changes should be considered along with steps taken to influence overall economic activity.

The Council of Economic Advisers, in emphasizing the importance of moving to combat cyclical unemployment, was not seeking to minimize the need for appropriate action to help relieve conditions arising from structural changes of the type to which I have referred. Indeed the Council stated explicitly that such measures "should be high on the agenda of national policy." Reversal of the current downtrend in economic activity is, of course, a matter of first concern to all of us.

Representative REUSS. Now, a question along the lines of your discussion with Senator Douglas.

Am I right in thinking, Governor Martin, that since you have now utilized the powers given you under the vault cash law passed by Congress a couple of years ago, to count vault cash and to meld together the reserve requirements of certain classes of banks, it will be the policy of the Federal Reserve in the period ahead to make necessary increases in reserves by the purchase of U.S. securities rather than by a further lowering of bank reserve requirements ratios?

Mr. MARTIN. Well, I think that is what is happening at the moment. But I couldn't in all honesty, Mr. Reuss, make any commitment as to how the Federal Reserve would handle that.

We have the authority to change reserve requirements under the law. We have just gone through a rather important readjustment of them.

Whether we will need to do anything along that line, or not, is a matter that I could not pass any judgment on.

Representative REUSS. You cannot speak for the Board, but let you and I discuss this.

It is my understanding, Governor Martin, that you are going to be creating new reserves of a half billion dollars or so in the next year, give or take a little, in order to furnish increases in the money supply. Governor Balderston and others have so testified before us. Since you are probably going to do that, if Governor Balderston and the others have testified correctly, how about doing it by the method of purchasing U.S. securities preferably on the long side?

Would not that be better for the economy and for the problems with which we now are confronted?

Mr. MARTIN. All I can say on this, Mr. Reuss, is that I think that is a judgment that you have to work with on a day-to-day basis, and in terms of what the circumstances are.

Representative REUSS. But if the circumstances are as they are today, and you determine that the reserves of the banking system needed to be increased for good, valid, noninflationary reasons, would you not agree with me that the sensible and wise way to do it is by buying longer term U.S. securities, rather than by buying bills, or by further reducing the reserve ratios of the banks?

Mr. MARTIN. I think that is the way we are operating at the moment, but that does not necessarily mean that that is the way we will continue to operate.

You are raising here the sort of problem that we have to face up to. Whatever we buy adds to our portfolio, but under different conditions we might find it necessary to sell them.

When you talk about profits to the Treasury, it might be that we would have to take losses on some of the securities that we purchase.

We cannot just take our portfolio of $25 billion and take this segment of it and say this will be permanent, because here we are dealing with the overall interest structure that, as I say, is compounded by the composition of the Federal debt.

Most of that Federal debt has grown up like Topsy, sometimes by necessity, for the Treasury has had to finance on the basis of expediency.

That is the point I was making to Mr. Boggs on the 4¼-percent ceiling.

I think we have to recognize that.

The reason I mention that is that I hope you and others will not be critical of the Federal Reserve if you find we have taken a loss on some of these securities that we have acquired.

We are not in the business of making profits.

Representative REUSS. Taking a loss on some of the long-terms that you now are acquiring?

Mr. MARTIN. Yes.

One of the reasons for dealing in short-term securities is that the loss is usually a negligible loss, if there is one, and you can run it off in a reasonable period of time.

Representative REUSS. You now have approximately $1½ billion of securities of 5-year maturities, and more out of a total portfolio of $26.5 billion; is that not so?

Mr. MARTIN. That is right.

Representative REUSS. Would the world come to an end if you very markedly increased the long-term portion of your portfolio, so that instead of holding just a tiny fraction, 5 or 6 percent, you held a very substantial fraction in longer term U.S. securities?

Mr. MARTIN. I would not say that the world would come to an end at all. I have never contended that.

Representative REUSS. Would anything happen to it?

Mr. MARTIN. I don't know what the size of the Federal Reserve portfolio ought to be, but this is that money stream that you and I have discussed many times, and we have just a shade of difference as to how it should be managed.

Your judgment may be better than mine. I simply want to state that I have a little difference with you on how we should manage it.

Representative REUSS. I want to know what your judgment is before I can tell you whether we differ.

I have used my time now.

Mr. MARTIN. I am not trying to debate it, but I don't believe we can spell out this kind of difference, because this is purely in the area of judgment.

Representative REUSS. I will return when I can.

Mr. MARTIN. Thank you.

Representative REUSS (presiding). Mrs. Griffiths.

Representative GRIFFITHS. I am happy to see you again. I am particularly interested in the position that each person has given before us in regard to trade in their statements.

It is necessary that we be competitive, of course.

In this morning's lead article that I read in the Wall Street Journal, they pointed out that we had lost a contract some place in South America, I believe, for steel, because three other nation's industries had underbid us.

Could you tell me if you raise or lower interest rates by 1 percent, can you trace that into the price of steel?

Mr. MARTIN. I think that is very difficult to say. I wouldn't say there is no impact, but I think it would be very difficult to establish any direct relationship.

But the point you make, and that is a very good question, on the competitive problem we are facing, and which concerns me, is that at the present time we have some people saying "Well, when we get recovery we won't have any competitive problem; we won't have any balance of payments problem."

I am not saying that you said that, but I have heard that in various discussions.

I think we must be competitive or our balance of payments problem will not be solved. That is the basic problem with which we have to deal.

Our interest rate policy ought to do everything that we can do to be helpful on that.

But it is a relatively minor factor.

Representative GRIFFITHS. And in the last analysis, it is not within your control to set the price of steel?

Mr. MARTIN. That is exactly right.

Representative GRIFFITHS. May I ask you, and you have had quite a lot of experience in Government, do you know of any agency in Government that today, by any action, can affect the price of steel, either up or down?

Mr. MARTIN. I don't think I do, Mrs. Griffiths.

Representative GRIFFITHS. Then when we consider the statements of people who have testified before us, who have expressed both the belief and the hope that America become competitive in world markets, there is not today available to the Government one single thing that would make America competitive in the world markets; is that not true?

They have not at hand one single action that they can take?

Mr. MARTIN. I am not trying to explain the administration, but I would say this labor advisory group that the President has set up is certainly one activity that might exert a profound influence.

Representative GRIFFITHS. I have listened carefully as each person made the explanation. The hope of the Labor Advisory Committee must be that it will bring publicity to bear upon both too high profits and too high wages.

Mr. MARTIN. That will bring the two parties together to recognize this problem that you are so rightly pointing up.

Representative GRIFFITHS. I must say I personally feel if that is our only hope, where you are putting human greed and human power, and against it merely a hope of reducing it, then we are based upon a very slender reed.

Mr. MARTIN. I only make the observation that competition is a pretty powerful force, and competition is working at the present time to establish costs which will be competitive.

Representative GRIFFITHS. But, of course, the competition in world markets, whether or not an industry sells within a world market, is based somewhat upon the fact that their relative position in America is so much better that there is no need to make that extra effort to sell it to the world market; is that right?

Mr. MARTIN. Yes, that is perfectly true, except as the pressure grows, they have, on their profit margins, to expand their markets, you see.

That is the competitive process.

Representative GRIFFITHS. Thank you very much.

Representative REUSS (presiding). Mr. Curtis.

Representative CURTIS. Mr. Martin, I wanted to get back to the OECD a little bit.

Mr. MARTIN. Very well.

Representative CURTIS. I will read a passage in an article appearing in Commercial and Financial Chronicle of Thursday, February 23, by Herbert Bratter:

> One of the principal arguments advanced by Secretary Dillon for our ratification of the OECD convention is that OECD will bring about coordination of the monetary and credit policies of its members and make it possible to avoid such developments as our capital and gold outflow last year.
>
> The policies of the 20 central banks of the OECD countries will be coordinated. Our Federal Reserve Board, for example, will keep in close and more or less continuous contacts in OECD with the central banks of Britain, Canada, and continental countries, and vice versa, before instituting policies which, whatever their validity for domestic purposes, may have undesirable effects on other OECD countries.

The only reason I read that is the request that I was going to make to the Chairman.

Would the Federal Reserve have a statement, a considered statement, for insertion in the record as to your position on OECD as you have expressed it, that you do not feel that this would in any way affect your independent judgment and powers that you presently have.

I cannot believe it would, myself, in this treaty, but I think it is a very important thing, particularly as the Federal Reserve has not commented.

That was my first question.

You have not made an official statement on it. Would you care to do that and would you prepare a statement for us.

Mr. MARTIN. I will be very glad to, Congressman Curtis.

(The material referred to follows:)

STATEMENT OF THE BOARD'S VIEWS ON OECD

In the modern world of interdependent nations, suitable international forums in which economic questions of mutual interest can be considered and discussed have an important role to play. In the postwar period the Organization for European Economic Cooperation has provided one such forum for its member countries in Western Europe, and for Canada and the United States, which have been associate members. The proposal to reconstitute the OEEC as the Organization for European Economic Cooperation and Development (OECD) results from the great change in economic conditions and economic problems in the past decade, and particularly from the reestablishment of world multilateral trade and the convertibility of most leading currencies. In addition to its other activities, the OECD would provide the basis for continuation and intensification of international economic consultation and cooperation among the countries concerned. Member countries would thus be provided with an opportunity to inform themselves more fully than might otherwise be possible regarding the policies of their fellow members, and to express their views regarding the consonance of such policies with their own economic interests.

It must be remembered, of course, that there are practical limits on the extent to which it is possible to reconcile the economic policies of different countries. These limits result from the variation among their economic conditions, among their techniques of economic control, and, at times, among their views as to what policies are suitable in particular circumstances. On various occasions, representatives of the United States in Paris negotiations have pointed out the existence of such limits, and the Board of Governors fully agrees with this view.

The Board of Governors understands that nothing in the Convention embodying the proposed organization would affect the present status of the Federal Reserve System in the structure of the U.S. Government or its independence of judgment and action in the field of monetary policy.

Representative CURTIS. Mr. Chairman, I ask unanimous consent that the complete article be made a part of the record at this point.

Representative REUSS (presiding). Without objection, that may be done.

(The article referred to follows:)

[From the Commercial and Financial Chronicle, Feb. 23, 1961]

THE CASE FOR THE OECD IS WEAKER THAN ITS ADVOCATES CARE TO ADMIT

(By Herbert Bratter, Washington, D.C.)

Adding still another international financial institution to those already providing opportunity for consultative and voluntary coordinative banking, fiscal and economic policies makes little sense to experienced observer who critiques testimony favoring our admission to OECD. Mr. Bratter is surprised there is no testimony from the Federal Reserve at the current Senate hearings, and he ponders whether proposal of unenforcible cartelization of interest rates and supranational control of policies is but a backdoor way to end completely the Federal Reserve's independence.

There is now before the Senate for ratification a convention creating the Organization for Economic Cooperation and Development (OECD). This is to be a successor to the Organization for European Economic Cooperation (OEEC), under which the European beneficiaries of the Marshall plan cooperated. The new organization is to include not only the 18 nations which belonged to OEEC, but as well the United States and Canada.[1] OECD is to be a consultative and policyshaping body. As stated by Secretary of the Treasury C. Douglas Dillon—who in his previous position in the State Department had considerable to do with the planning of the OECD—the latter is to "provide the means for converting common policy objectives into effective action." OECD's official aims are: maximizing economic growth, helping less developed countries and contributing to world trade expansion.

One of the principal arguments advanced by Secretary Dillon for our ratification of the OECD convention is that OECD will bring about coordination of the monetary and credit policies of its members and make it possible to avoid such developments as our capital and gold outflow last year. The policies of the 20 central banks of the OECD countries will be coordinated. Our Federal Reserve Board, for example, will keep in close and more or less continuous contact in OECD with the central banks of Britain, Canada, and continental countries, and vice versa, before instituting policies which, whatever their validity for domestic purposes, may have undesirable effects on other OECD countries.

It therefore behooves all who are interested in monetary and credit policy and broader national economic policy to familiarize themselves with the Secretary of the Treasury's testimony and some of the questions raised during the recent Senate hearings. First let us turn to the prepared statement distributed by the Treasury Department, insofar as it deals with the matter of interest rates and the gold outflow of 1960. From that statement we quote:

[1] The OECD Council may invite other governments to join OECD.

"To illustrate the need for better international coordination of economic and financial policies I would like to refer to last year's movements of international short-term capital.

"During the first half of 1960 our balance-of-payments deficit on an annual basis was $2.7 billion—down markedly from the level of $3.8 billion in 1959. Last spring our Federal Reserve discount rate was at 4 percent, the German Bundesbank rate was 4 percent, and the Bank of England rate was 5 percent. In other words, all those rates were close together. Then, as business began to slow in the United States, our Federal Reserve began to ease credit and reduced its rate first to 3½ percent, and later to 3 percent. Meanwhile the German Bundesbank, with its eye on the domestic boom in Germany, and with the objective of controlling inflation at home, increased its discount rate to 5 percent in June. The Bank of England promptly followed suit and upped its rate to 6 percent.

"These actions brought about a sharp imbalance in short-term interest rates. The results were bad for all concerned. A flood of short-term funds left New York seeking the higher return in Frankfurt and London. This sharply increased our balance-of-payments deficit from an annual rate of $2.9 billion in the first 6 months to a rate of $4.7 billion in the second 6 months. This sudden and sharp increase shook confidence in the dollar and the result was a substantial increase in the outflow of gold. This in turn brought on the speculative outbreak in the private gold market in London last October when, for a day or two, gold sold at $40 an ounce. Meanwhile the large inflow of American funds frustrated the efforts of the German authorities to tighten up on investment in Germany. When this became clear the German and British authorities cut back their discount rates, the flow of short-term capital slowed and confidence was gradually restored.

"The lesson to be learned by all this is that in these days of convertible currencies there must be close cooperation and coordination between our financial and monetary authorities and those of the major industrialized countries of Western Europe. This is now recognized on all sides. The OECD is the forum in which this coordination can be worked out and through which we can avoid similar episodes in the future. As such it is a vitally important element in our drive to right our payments deficit without infringing on the actions that must be taken to reinvigorate our economy at home."

UNCONVINCING ARGUMENT

There may be other and persuasive reasons why the United States should join the OECD, but the argument of the Secretary's just quoted does not sound convincing. In effect the Secretary is saying that, had the OECD existed a year ago, the October gold "episode" could have been avoided. That episode had its roots in our payments deficit, long in the making. It is not self-evident that, had there been more consultation among the central banks of the United States, United Kingdom, and Germany through an OECD forum in 1960, there would not have occurred the short-term capital and gold outflow from the United States.

In this connection we must remember that 1960 was a United States election campaign year. During the campaign the opinion was widespread abroad and also here that Candidate Kennedy's statements about making money cheaper and his apparent threats to the independence of the Federal Reserve system did much to weaken world confidence in the external value of the dollar. This was made clear to the present writer inter alia in correspondence from London. Only on October 30, some days after the price of gold had touched $41 in London, did Senator Kennedy make public a formal and detailed statement at Philadelphia, his strong pledge to defend the dollar. Still confidence was not fully restored and gold continued at a premium in London, despite the sale of U.S. Treasury metal through the Bank of England. Not until after Mr. Kennedy had become President did the premium price disappear.

In a letter to this writer, a well-known British financial expert wrote last month:

"It seems that Kennedy will not devalue the dollar; at any rate it does not seem to be his present intention. Why in the sacred name of reason and commonsense did he not make this plain at an early stage of his campaign, instead of leaving it to the last moment? He is advised by the best brains, yet they seem to have overlooked such an elementary matter. Had he declared himself against devaluation from the very outset we might have avoided the October gold rush."

Had an OECD forum existed in 1960, what could the Eisenhower administration's or the Federal Reserve Board's representatives at the round table have told the other 19 countries by way of allaying the alarm of the "hot money," fleeing into foreign banks and securities and into hoarded gold abroad?

The above-quoted Treasury statement validly argues that interest rates in Europe considerably higher than those here caused an outflow of hot money. But that was not the whole story. It is well known that Switzerland kept its interest rates lower than ours; that Swiss banks later were ordered to pay no interest on hot money, but rather to make a charge for such deposits; and that Germany took other measures—offsetting the high-interest rate—to discourage the capital inflow from the United States—and yet hot money moved out of this country into Switzerland and Germany. Clearly, something more than equalization of interest rates was needed. Chiefly what was needed was reassuring news from the United States.

SENATOR FULBRIGHT INQUIRES

The administration's argument for the OECD leaves the implication that consultation in that forum will have the result of producing more harmonious discount rates among the 20 member countries. It is implied that the Federal Reserve Board's policies, as well as the policies of the Bank of England, the German Central Bank, etc., will hereafter be attuned more closely to the needs of the OECD community as a whole than to strictly national requirements. But, at the same time, Secretary Dillon has testified that there will be no coercion on the Fed from OECD. The transcript seems a bit fuzzy. Thus:

"Chairman FULBRIGHT. How will this help in the balance-of-payments problem?"

"Secretary DILLON. It will most immediately help * * * in this problem of short-term flows.

"This is the problem which complicated our balance of payments last year when, because of the disparity in interest rates * * * the United States lost some $2 billion * * * in the second half of last year, an increase of $2 billion over the going basic rate of deficit. * * *

"Now, through the OECD we will have a forum. There has to be some forum if we are going to have better coordination between rates in Europe and the rate here in the United States.

"It became obvious last year that as business eased here, our money should be eased, that our Federal Reserve should lower its rediscount rate. That was in the interest of easing the recession here, and that was in the interest of all the countries of Europe.

"It was not in their interest to see a recession in the United States.

"Conversely, at that time there was a boom going on in Europe and * * * the Germans in particular * * * to try to hold that within bounds sharply increased their rediscount rate.

"Now this would have been fine if they had been operating in a vacuum, but it did not work because they were not, and the flow of funds that was started by that from the United States frustrated their own efforts and made it clear that their action in raising the rediscount rate last June was an unwise action.

"When they discovered that, they, promptly in the fall—it was about December—cut this rate back again to where it had been in the first place. Now if we had a forum where we had been talking together at that time, this sort of thing would have been discussed.

"Naturally, there would have been no binding commitments, nobody would have to obtain permission of anybody else to act, but you, then, at least would have had this opportunity to point out what the results of action would be, and you could have taken into account the international effect, and I think certainly this is needed in the future. * * * OECD will provide that forum. Therefore we consider it of vital importance in the Treasury Department to handle this porblem of short-term flow of funds, which is going to be much more serious from now on because * * * all the major currencies are fully convertible."

REASSURANCE ON FED'S INDEPENDENCE

"Chairman FULBRIGHT. Well, it is clear that the OECD does not have the power to fix discount rates?"

"Secretary DILLON. Absolutely clear. It has no power to do anything except make recommendations to countries, which they accept or do not accept, if it has been unanimously approved, in accordance with their constitutional processes, and it is certainly not the intention, and it will not be used, to try to fix uniform rates, although there will be an opportunity for the authorities in each country, which is very necessary, a necessary thing, to discuss these matters * * * with each other on a continuing basis."

"Chairman FULBRIGHT. Then it is clear that this will not affect the power of the Federal Reserve Board to alter our discount rates?"

"Secretary DILLON. Completely clear; yes, sir."

THE CASE OF GERMANY

Since the Fed is not to be subjected to OECD orders, what about other nations' central banks; Germany's for example? Senator Byrd asked about this, too. The Secretary replied that, had OECD existed last year, the German boom need not have gone unchecked. As collective reasons dictated against a rise in the German discount rate, the German boom could have been tempered by fiscal policy or other means. What these fiscal and other controls would have been, the testimony does not specify. However, a question that suggests itself is this: If other means than discount policy would have done the job in Germany, could not the Germans argue that the same applies to the United States?

We again quote from the hearings:

"Chairman FULBRIGHT. One other problem occurs. If Germany needed to increase its rates * * * to handle its economy, its domestic economy, and you persuade them to lower them, what happens; does the boom then become released in all its fury, or how do you insulate the problem that occurred there, from our problem or the international problem?"

"Secretary DILLON. Well, one can handle these problems by different ways; not just by monetary means. You can handle them by fiscal policy, and so forth.

"Now what has happened in the case of Germany was that they chose to use monetary means to restrain their tendency toward inflation. These monetary means did not work, because all they did was to cause a great flow of funds from the outside, principally from the United States, into Germany. So the boom went on at an even greater rate than it probably would have otherwise. * * *If there had been a chance to consult and confer and take into account the international repercussions, I do not think they would have ever taken this action.

"Now the situation is such that this is really the first time that such a situation has arisen since currencies have been fully convertible * * * so that anything that one of us does is bound to affect the others and, in turn, that would react on us. So this sort of matter has to be considered in that framework now."

"Chairman FULBRIGHT. This sounds as if this is primarily an educational venture to inform the authorities of each country what the status of the world is, and to educate them on the consequences of their contemplated action; is that right?"

"Secretary DILLON. I would think in this economic policy committee where we discuss general monetary and financial policies, that is exactly what it is. It is a place for an exchange of information, a continuing exchange * * * between the people who are responsible for policy in each of these important countries."

Senator Fulbright brings out that the OECD is primarily an educational venture; "that is exactly what it is," says Mr. Dillon. Both in the Secretary's prepared statement and his oral testimony one is given to understand that had the heads of the British and German central banks only been better informed last year, they would have abstained from the monetary policies they actually followed. But that assumption it is unsafe to make. It is doubtful that our arguments would have prevailed upon the British and Germans last year not to use monetary policy to dampen their booms, any more than that our Federal Reserve would have maintained a tight money policy here on the advice of the Bank of England or the Bundesbank.

Indeed, one expert in this field argues that it would have been very unfair in 1960 for the United States to have pressed London to refrain from tightening credit in the regulation of the domestic economy. Also, it may not be fair to imply that the European central bankers are ill informed on world economic conditions and need education from us. While consultation is desirable and in fact has been taking place all along, it takes more than consultation to solve some problems.

ONE MORE FORUM

The International Monetary Fund was endorsed by the Congress in 1945 in important part precisely because it would provide a continuous forum for the discussion of international monetary matters. Among these matters is the balance of international payments. The Fund is well aware of the monetary and credit policies of its members and their central banks. The Fund maintains a balance-of-payments division. All the major financial powers are represented on its board of executive directors, which sits in Washington in continuous session. There should be ample opportunity there for consultation. The U.S. Executive Director has offices in both the Treasury Building and the Fund Building. He sits in on meetings of the U.S. Government's National Advisory Council. The British and the Germans have executive directors in the Fund. The British Treasury, moreover, maintains a Washington office of its own.

Nor are other contacts between the financial officials of the various countries negligible. Central bankers are always exchanging visits, even though on an irregular basis. Officials of the New York Federal Reserve Bank and members and employees of the Federal Reserve Board often visit other central banks; and foreign central bankers and finance officials visit in New York and Washington. The annual meetings of the IMF bring together the governors and other officials of all the member nations; and at recent annual meetings the U.S. balance-of-payments and interest rate differentials were discussed at length, formally and informally. The IMF consults with members in Washington and through missions sent abroad.

European central bankers also enjoy the meeting ground long provided by the Bank for International Settlements at Basel. That bank, created 30 years ago for reparations purposes, boasts as its chief raison d'etre that it provides a place for the frequent and regular interchange of ideas among European central bankers; and it is visited by Federal Reserve officials from time to time. The BIS in turn regularly attends as observer the annual meetings of the IMF, while the latter attends the BIS' annual meetings and visits the Basel institution frequently between those meetings.

For European central banks another channel for consultation is the machinery of the European Monetary Agreement, successor to the recent European Payments Union.

Asked why another international consultative financial body is now needed, a U.S. Treasury spokesman explains that OECD will provide frequent contacts between the officials who execute policy in the 20 countries. That still another organization is needed is not clear. Bureaucracy is known to reach out for new fields and one may wonder whether this particular aspect of the OECD is not a case in point.

HOW BIG THE U.S. VOICE IN OECD?

Secretary Dillon, in reply to other questions of Senator Byrd, explained that the OECD would not do what the European Payments Union did in the OEEC days; nor would it lead to a common currency for the 20 OECD countries. "Monetary operations, anything that would be substantive, is the duty of the International Monetary * * *."

Another administration witness gave the Senate committee to understand that the United States will have pretty much its own way in the OECD. We are left to infer that, in a situation such as that of last year, if our economy calls for easy money, and Germany's for tight money, we shall have easy money and Germany will adjust its policies to our needs. This seems to be expecting a great deal from OECD.

Senator Morse, quizzing Under Secretary of State for Economic Affairs George Ball and Secretary Dillon, probed for information on how the OECD would reach its decisions. "You get unanimous agreements in international diplomacy by give and take," Morse observed. Then occurred this exchange:

"Mr. BALL. Senator, I should say this, that the bargaining power of the United States, as the most important, powerful member of the OECD, will be such that I see no reason why we should compromise any of our policies." [2]

"Senator MORSE. If I had not had 3 months' experience at the United Nations, you might sell me that argument, Mr. Secretary, but you cannot sell it to me because I have seen it time and again in a position of great power on the basis of trying to please some dictatorships, and that is why I am raising this question. * * *"

Whereas Secretary Dillon believes that, had the OECD been in existence a year ago, the Fed's easier money policy would not have been compromised by the inconsistent discount rate policy on Germany's part, Senator Morse leaves us in doubt that the U.S. position will always prevail.

Senator Morse posed a hypothetical problem: "OECD unanimously makes a recommendation that would affect the United States, let us say, in regard to some monetary policy. It is adopted unanimously.[3] Tell me what happens to it then."

Mr. Ball explained.

"To the extent that the exercise of this monetary policy were something which was clearly within the Executive authority in any event, then the Executive would carry out the monetary policy along the lines of the recommendation."

We quote further from the transcript:

"Senator MORSE. Suppose the U.S. delegate reached an agreement with the German and British and other members on discount rates. Would that fall within the power of the Executive, in your opinion?

"Secretary DILLON. * * * The Executive, as such, cannot tell the Federal Reserve Board what to do, so he could not make that sort of an agreement that was a flat agreement as to what would be done on interest rates in the United States, even if it so desired, because it would not be binding on the Federal Reserve Board. * * *

"Senator MORSE. But could it reach a recommendation to be transmitted to the Federal Reserve Board?

"Secretary DILLON. That would be possible. But that would not be binding on the Board, and the Board has not been noted in the past for taking recommendations that they did not feel were—that they did not agree with, and I think that they are fully independent, and that would continue.

"Now we would expect, as a practical matter, which is different from this theoretical approach, that the Federal Reserve representatives would take part in this sort of economic consultation."

Senator Morse asked the Secretary whether, if this "claimed advantage" had been in existence at the time, the financial trouble of 1960 might have been avoided, by "working out something" with Germany and Britain. Mr. Dillon answered:

"I think we would have, because I think we could have been able to point out to them that the action that they took would have very serious effects on the dollar. They are very interested in the dollar. That sort of an effect hurts them, too, and we would also have been able to show them it would have been ineffective for the purposes for which they wanted to put it into effect, so in their own free will they would have, I think, acted differently than they did act.

"But there would have been no binding thing in this agreement that would have required them to do so."

Senator Morse explored with the Secretary the Fed's authority to enter into agreements with other countries with regard to discount rates. Mr. Dillon did not think the Fed has that right; nor would the OECD treaty give it to the Board. Morse wished to make sure that the treaty was not "enlarging the jurisdiction

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[2] Each OECD member country will have one vote.
[3] Although 1 or more members may abstain from voting, an OECD recommendation may still be "unanimous."

of the Federal Reserve Board and I do not know how many other institutions that we may have. * * *" The Secretary reassured the Oregon Senator on this point.

Mr. Dillon suggests that just pointing out to the Germans that the action they take would have very serious effects on the dollar would suffice to get the Germans to follow a different course. But the sad story of the Anderson-Dillon mission to Bonn last fall and the persistent German effort to saddle us with part of the obligation which they undertook in lieu of paying reparations to the United States after World War II lend little support to such optimism. Subordination of national monetary policies to the common good of the 20 OECD countries may be a worthwhile desideratum, but it seems to be as far away as a single international currency, issued by a single supranational monetary authority.

FEDERAL RESERVE UNHEARD

Considering the importance given by the administration to the monetary aspect of OECD's functions, it is surprising that the Senate committee did not seek testimony from the Federal Reserve System. In the light of the fact that the OECD has unqualified administration backing, such testimony might have thrown light on the Board's independence under the new government.

As indicated above, the Federal Reserve believes in cooperation and consultation with other central banks. What we do not know is how the System feels about the type of consultation outlined in the Dillon testimony. Whether in practice consultation within the OECD will be formal or informal we do not know yet. Even if it is informal, the "forum" is intended to develop into something stronger, leading to a cartelization of interest rates and supranational control of policies heretofore the sole prerogative of independent countries. Heretofore, when we have mentioned the Fed's independence, we have had reference to its relations to the Treasury and the administration. Once OECD starts functioning, we shall need to watch for any subordination of that independence to the interests of the Atlantic Community. And the same will me true of central banking in each of the other 19 nations. Not merely central banking, but also fiscal and economic policies, for as pointed out by Mr. Dillon, these are alternatives to monetary policy.

It might be interesting to speculate on the consequences if some member government abstains from a monetary policy it desires to execute and instead, following our urging and leadership in OECD, adopts one that is unpopular in its country or has harmful political consequences. We might be charged with interfering in other peoples' affairs and even with responsibility for changes in governments. Or, if a unanimous OECD causes the Fed to follow an unpopular policy here, one can conceive of the Bank of England being charged with dictating to us. If on the other hand we go our own way willy-nilly, ignoring an OECD "unanimous" recommendation to us, shall we not be charged with scuttling international cooperation?

THE FED'S INDEPENDENCE

Our representative in the OECD, presumably, will be an Ambassador representing the State Department. Because monetary and fiscal policies will be on OECD's agenda, our Ambassador will have at his elbow representatives of the Treasury and Federal Reserve System. Secretary Dillon, as quoted above, considers OECD's functions in respect to financial and balance-of-payments matters "of vital importance in the Treasury Department." The Federal Reserve, therefore, may be put under considerable pressure to discuss its future policies in advance and perhaps even to form those policies in cooperation with the Treasury and State Department. This suggests something more than the constant consultation between Treasury and Fed which has been the practice in Washington. By the 1951 "accord" the Fed recovered its independence from the Treasury. The time may come when it will want an accord with the State Department. The latter naturally seeks to use all the resources of the Nation it can tap for the purposes of foreign policy. When General Marshall became Secretary of State, for example, he thought it only natural that he should request the Export-Import Bank to make loans for political purposes; and it was William McChesney Martin, then Eximbank's head, who got President Truman to settle the issue in Eximbank's favor.

It is not hard to imagine circumstances under which the Fed will be subjected to strong moral pressures in OECD to act against its convictions for the sake of foreign policy.

EFFECTS ON CENTRAL BANK PRIVACY

It is something new for us to think of the Federal Reserve, having reached a decision to make a major change in policy at a turn in the business cycle, first submitting to the discussion and debate of the outlined OECD procedure. Until now, when the Fed has undertaken such a change it has not telegraphed its decision. The latter usually is detected only in the changes it brings about. Once a Fed decision is made, it is promptly put into effect. To debate the matter around the table at OECD would involve delay and the chance of leaks. Consequent speculation might compound the Fed's problems.

By the same token, it is not easy to imagine the Old Lady of Threadneedle Street submitting to the gauntlet of OECD interrogation and advice on such an occasion.

LEAST COMMON DENOMINATOR IMPRACTICABLE

The "monetary policy" argument for the OECD boils down to a policy of compromising differences in interest rates among different nations. If our interest rates and those of Europe had been closer together, it is argued, we should not have had the hot money outflow. But there is no reason to suppose that when a nation's economy calls for a certain interest-rate policy on the part of the central bank, some rate short of the necessary one will be adequate. Admittedly, national economies are not immune to what is going on elsewhere in the world; but they do not all run in unison. Last year the United States had a recession while Europe and Japan were booming. A uniform interest rate policy, a least common denominator of the needs of all, most likely would satisfy no one.

Moreover, even if we had not had a hot money outflow in 1960, increased by higher interest rates abroad, we still would have had an adverse payments balance. Such a deficit, long enough continued, tends to bring a capital outflow regardless of interest-rate differentials.

MORE DELIBERATION NEEDED

There are some who argue that, considering the deterioration of U.N. affairs, the Atlantic community needs something like OECD as an economic supplement to NATO, as something to fall back on in an emergency. Protectionist interests have voiced loud alarm over the OECD's possible role in influencing U.S. commercial policy. Indeed, but for this alarm the OECD convention might have slipped through the Senate with little more than perfunctory attention.

The OECD's potential role in the field of monetary policy and central banking has been little advertised, until brought to the fore by the Treasury's testimony. The Senate hearings have now been closed, without testimony from the Federal Reserve; and there will be no House hearings under the administration's legislative plan.

Since, as revealed above, the OECD's monetary and economic influence could have far-reaching domestic effects, it would seem regrettable to rush the convention through the Senate without more thorough exploration of the potentialities and, particularly, open testimony by spokesmen of the Federal Reserve System. The arguments which have been made on this aspect during the hearings lack a convincing ring. Some outside experts consulted by the writer think the arguments do not make much sense; that we should be "kidding ourselves" to accept them fully.

The case is not made that we need another international monetary forum; that the IMF, in which we have made so heavy an investment, is not adequate in the field for which it was created; that the major Federal Reserve decisions should be arrived at in Paris; that still another international bureaucracy should by added to an already overlong list of financial institutions. The OECD may be worth while, but, if so, it needs to be better understood.

Representative CURTIS. Then I have one line back to our unemployment.

That is a challenge that I will be very pleased to accept. And I am very pleased, of course, that Mr. Martin is going to comment. I think there is a fundamental conflict between the position presented by the Council for Economic Advisors and the position expressed in your papers, and that is why I express such pleasure in a sense, that at last we are getting some of these things out in the open.

Here is something that we ought to be able to determine. If our unemployment is of the nature as described by the Council for Economic Advisors, and I cannot believe that it is in light of what evidence we have, then that does indicate certain policies to be pursued and might justify some of the proposals by the Kennedy administration.

If, on the other hand, there is a misconception of what unemployment there actually consists of, then they are applying the wrong remedies, and I am satisfied, indeed, they are applying the wrong remedies.

This becomes a very key and vital thing to determine.

For many years now, 3 or 4, I have been asking for rather detailed studies of the nature of who are the unemployed. I do not believe we have paid enough attention to that.

In my judgment, we are seeing the incidence of very rapid technological growths and the growing pains which accompany that, which is quite a bit different concept of our economy than one which is tired and sluggish, and apparently sick, as some people have even said.

Representative REUSS. Senator Bush?

Senator BUSH. I have no questions, Mr. Chairman.

Representative REUSS. Mrs. Griffiths?

Representative GRIFFITHS. No questions, Mr. Chairman.

Representative REUSS. I have just a point or two.

At the end of your testimony, Governor Martin, you reprint the February 20 press release of the Board of Governors, which sets forth your new policy.

I take it that this press release reflects a resolution or a motion adopted by the Open Market Committee just as the "bills only," policy was set up back in 1953 by a motion with recorded votes.

Would you make available to this committee the formal action taken by the Open Market Committee in modifying its policy?

Mr. MARTIN. Well, Mr. Reuss, I think that would be a completely different way from any way we have handled it before.

If we are going to give out our instructions to the desk we might just as well invite the whole market in to participate in our deliberations.

Representative REUSS. I recall that the bill's only policy was formalized in a resolution which one could read and ponder. As you said in your testimony today, you had your say on it and so did Mr. Sproul, Mr. Hayes, and the others, all which was very illuminating.

Mr. MARTIN. Over a period of years. In due course, as our annual report comes out, all of this will be revealed.

But I don't think while the market is operating, that we should do this. This statement was made exactly at the time that we made transactions because of that previous statement so that no one would think we were trying to mislead the market.

But that should not be put into the framework of indicating future action—what securities we might buy, when, where, and how much, which is what really you are asking for.

Representative REUSS. I am really not—I am really interested in what the Open Market Committee did decide and its reason so that the Joint Economic Committee can evaluate its action.

When can we expect your annual report to be delivered to us?

Mr. MARTIN. That will be next year's annual report.

Representative REUSS. When, Mr. Martin?

Mr. MARTIN. Next year. It would be about March of next year, a year from now.

The current annual report will be out within a week or 10 days.

Representative REUSS. I do think that you are asking the Congress to wait an awfully long time for your reasons on a decision you have already made.

Mr. MARTIN. I spelled the reasons out in this statement as clearly as we think. We have been told that we do not give enough information on why we do things, and I clearly put in here the domestic economy and the balance of payments as our reason for doing this.

How we were going to operate, what the technique was, other than beyond a change, that is about all——

Representative REUSS. Can you comb out of the resolution passed by the Open Market Committee all information which could possibly do any harm and let us see the rest of it? I would like to have that.

Mr. MARTIN. My whole statement was directed toward that elucidation, Mr. Reuss.

Representative REUSS. And you have not a syllable more that can be revealed at this time?

Mr. MARTIN. Well, I will certainly take a look to see if there is anything further that we can give, but you must remember the nature of the Federal Reserve.

We have 12 presidents and 7 board members. That is 19 people. They take decisions for various reasons.

We try to put them together and sometimes we try to act. We are not always in agreement. That is the whole nature of the System.

We are different than the Treasury Department or other departments of Government because we are more like your committee. You have differences of opinion on your committee.

Representative REUSS. It is precisely because you do have those differences of opinion that I do not want to wait 13 months to find out what they are.

It has been very helpful to me over the years to know that Mr. Hayes thought one thing, Mr. Sproul thought another and you had your opinion.

This is very helpful.

I would like to know who is on what side, on this one.

Mr. MARTIN. Well, that is one thing. But I don't think we ought to put it into that framework.

Distinct from your committee, for example, we have a market responsibility.

Representative REUSS. I could not agree with you more, and I do not want you to reveal anything to the Congress, or to the committee, which would in any way impinge on your market responsibilities.

However, I am suggesting that there may be portions of that resolution which it would be possible for you to disclose to the Congress of the United States without asking them to wait 13 months.

Mr. MARTIN. I will approach everything with on open mind, Mr. Reuss, but I really think that this statement was about as clear as could be made on what we were doing and why we were doing it at the moment.

I think the Federal Reserve Act contemplates this: There have been constant—since the time I have been there, there have been constant—sincere questions from people who think that the Open Market Committee, for example, ought to issue a statement after every meeting. To do that would involve a fundamental change in the Federal act——

Representative REUSS. I am not one of those. But I repeat that I do not wish to wait for 13 months for this important resolution.

Mr. MARTIN. I will follow through to the best of my abilities, but I would say so far as waiting 13 months is concerned, we have the press of the world making comments on this and have been making them every day. Some of that has been accurate and some inaccurate. But this is part of the problem that we deal with in markets.

Representative REUSS. Yes. Of course, my point is that the committee wishes to get it from the proper source rather than from press speculation as to what you have decided.

Mr. MARTIN. I might also point out—because I think it is important—that as to any possible assertions of secrecy, we issue a statement every Thursday, and our securities purchases, sales and exchanges are shown, net, in that statement. So we do operate in a goldfish bowl. The limits within which we can contain things within ourselves are not very wide.

I think that we try to give as much information as we possibly can; and, as you know, I am agreeable at any time for you or any other Member of the Senate or the House to raise any questions, and we try to be as helpful as we can.

But I doubt very much whether there is much we can add at the present time.

Representative REUSS. Well, I will read it in 13 months with a great deal of interest, and then we will see.

One final observation.

I would recall to you that in its report on employment, prices, and productivity a year ago, in February 1960, the majority of the Joint Economic Committee did unanimously express its view, the majority then including Senator Kennedy, that increases in the money supply be made through open market purchases rather than by lowering bank reserve requirements. And, further, that to the maximum possible extent the portfolio of the Federal should be lengthened.

I hope you will continue to bear in mind these wishes of the committee before you.

Mr. MARTIN. We have that report in front of us, and we are always very glad to have your observations.

Representative REUSS. Thank you very much, Mr. Martin, and Mr. Young.

The committee will now stand in recess subject to call of the chairman.

(Thereupon, at 4:30 p.m., the committee was recessed, to reconvene subject to call of the Chair.)

JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

MONDAY, MARCH 27, 1961

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

The committee met, at 10 a.m., pursuant to call, in room G–308, New Senate Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman (chairman of the committee), Bolling, Reuss, Griffiths; Senators Douglas, Proxmire, Pell, Bush, and Javits.

Also present: Wm. Summers Johnson, executive director, John W. Lehman, deputy executive director, and clerk, and James W. Knowles, economist.

The CHAIRMAN. The committee will please come to order.

Mr. Bell, the Washington Post and Times Herald reported this morning that the purpose of these hearings is to consider your nomination to be the Director of the Bureau of the Budget.

If that were the case, the committee would be happy to recommend your confirmation. I thought you would like to know you have our ex post pacto approval, and we are happy to have you with us.

One announcement: Mr. Hitch, Assistant Secretary of Defense, will not be heard this afternoon as was at one time planned.

This morning the committee will hear Mr. David Bell, Director of the Bureau of the Budget. The hearings are a continuation of the committee's hearing on the Economic Report of the President in which we are considering particularly the economic situation and outlook.

Director Bell, you may proceed in your own way.

However, before you begin, I would like to ask one question for the record which you may answer later if it is not covered in your testimony.

The reason I want to get my question in now is that I must leave to attend a hearing of the Rules Committee at 10:30 on the area redevelopment bill.

My question has to do with the amount which will be saved in interest costs in the next fiscal year. During the campaign Mr. Kennedy indicated that he expected to obtain the money needed to meet the cost of the new programs he proposed largely by savings on interest, through lower interest rates.

I hope you will put into the record, therefore, the amount you expect interest on the Federal debt to cost in the next fiscal year and indicate also what average interest rate on the Federal debt you expect to prevail during the year.

(The material referred to follows:)

Based upon the budget revisions submitted by the President, interest expenditures on the public debt in the fiscal year 1962 are estimated at $8.6 billion, as compared with $9.2 billion in fiscal year 1960 and an estimated $8.9 billion in 1961.

In preparing these estimated interest expenditures the Treasury projects the debt levels implicit in the budget, takes into account scheduled debt operations and computes interest outlays on the basis of rates existing at the time the estimates are made. Thus there is no forecast involved as to the future course of interest rates.

It should be noted, however, that the President stated in his economic message on February 2, 1961, and the housing message of March 9, 1961, the objective of encouraging a reduction in long-term interest rates to stimulate the domestic economy. Through the instruments of monetary policy and debt management steps are being taken in this direction.

The CHAIRMAN. Mr. Bell, you may proceed in your own way.

STATEMENT OF DAVID E. BELL, DIRECTOR OF THE BUREAU OF THE BUDGET, ACCOMPANIED BY ELMER B. STAATS, ROBERT C. TURNER, AND SAMUEL M. COHN

Mr. BELL. Thank you very much, Mr. Chairman.

We have a prepared statement of which I believe each member of the committee has a copy.

If it is suitable with the chairman and members of the committee, it might be well to put the entire statement in the record.

The CHAIRMAN. Without objection, it is so ordered at this point.

(The document referred to follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C.

[For release, Monday, Mar. 27, 1961]

STATEMENT OF DAVID E. BELL, DIRECTOR OF THE BUREAU OF THE BUDGET, BEFORE THE JOINT ECONOMIC COMMITTEE

Mr. Chairman and members of the committee, it is a pleasure to appear before you today to discuss with you the current budget outlook as presented in the President's message of March 24. The figures that I am presenting today reflect the administrative actions and recommendations to the Congress which have resulted from the President's review, over the past 2 months, of the programs and activities of the agencies of Government. This review is complete except for the defense program, on which the President will transmit his recommendations shortly.

Additional budgetary details supporting the figures in this statement are shown in a supplementary paper which is attached.

THE CURRENT BUDGET OUTLOOK

A. Fiscal year 1961

In the budget which was sent to the Congress on January 16, 1961, the previously estimated surplus had almost disappeared. In January 1960, the budget for fiscal 1961 anticipated continued and vigorous economic expansion and showed a surplus of $4.2 billion. In early October, in the midyear budget review, with signs of a sagging economy evident, the estimated surplus had shrunk to $1.1 billion. In January 1961, expenditures in the current fiscal year were estimated at $78.9 billion and revenues at $79 billion, yielding a surplus of less than $0.1 billion. This estimated surplus depended upon a number of assumptions with respect to both revenue and expenditures that now seem to have been in error.

Expenditures of the Department of Defense were clearly underestimated. Excluding the effects of any program changes made by the present administration, these expenditures in fiscal 1961, including military assistance, are now estimated to exceed the official estimate made last January by $544 million.

The January budget also assumed that the Congress would enact postal rate increases effective April 1, 1961, in time to decrease budget expenditures for the postal service by $160 million this year. It is now obvious that any increases in postal rates are unlikely to take effect before July 1. In several other instances, the January estimates of 1961 expenditures were understated, such as $50 million for loans of the Export-Import Bank and $74 million for veterans direct housing loans. On the other hand, expenditures were overestimated in some cases, notably by $423 million for farm price supports and related activities.

The net upward revision which it is necessary to make in the 1961 expenditure estimate, for the program set forth in the January budget, will amount to approximately $384 million.

Revenue prospects are difficult to assess at this time, since much depends on the seasonally heavy tax collections in March and April. However, the best judgment of the Treasury Department is that budget receipts in fiscal 1961 may fall short of the January budget estimate by as much as $500 million, principally because of a shortfall in individual income tax and excise tax collections.

Thus, excluding the effects of any proposed programs or budget amendments by this administration, we would have a 1961 deficit of about $800 million rather than the thin surplus of $79 million that was estimated in January.

Certain of the recommendations that the President has made to the Congress, and administrative actions that he has directed, will add to expenditures in this fiscal year. These increases are estimated at about $1.4 billion. This amount includes $574 million for temporary extended unemployment benefits (including railroad unemployment), $256 million for military functions of the Department of Defense (including speedier contract payments, acceleration of Polaris, and airlift modernization), $225 million for the price support and related activities of the Commodity Credit Corporation, $118 million for domestic surplus food distribution, and $64 million for farm ownership, operating, and housing loans. In total, therefore, the current prospect for fiscal 1961 is for budget expenditures of $80.7 billion, receipts of $78.5 billion, and a deficit of about $2.2 billion.

TABLE 1.—*Estimated budget totals, fiscal 1961*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$79,024	$78,945	+$79
Administrative actions and recommended program changes		1,364	−1,364
Total	79,024	80,309	−1,285
Necessary revisions in estimate for January budget program (not related to new proposals)	−500	384	−884
Revised estimate, budget totals	78,524	80,693	−2,169

B. Fiscal year 1962

In the January budget, expenditures of $80.9 billion were proposed for fiscal 1962 and revenues were estimated at $82.3 billion, yielding a budget surplus of $1.5 billion. The estimate of revenues assumed a prompt and brisk upturn in economic activity, as well as the enactment of various legislative proposals to increase revenues over their yield under existing laws.

As the President stated last week in his message on budget and fiscal policy, his recommendations for new programs and for appropriation amendments, excluding defense, will increase expenditures in fiscal 1962 by about $2.3 billion.

The additional nondefense expenditures include—

$500 million for aid to elementary and secondary schools, for the States and local school districts to use as they determine for construction, teachers' salaries, and special projects; an additional $30 million is esimated to be spent in 1962 for higher education ($21 million) and for medical education ($9 million).

$478 million for the Department of Agriculture, including $164 million for the costs of the Commodity Credit Corporation in supporting farm prices, distributing surplus foods abroad, and other activities, $169 million for domestic distribution of surplus foods, the food stamp pilot program, and the school lunch and special milk programs, $122 million for farm ownership, operating, and housing loans, and smaller amounts for the Forest Service and the Rural Electrification Administration.

$440 million for the fiscal 1962 portion of the temporary extended unemployment compensation program. Under this program, as recommended by the President and passed by the Congress, the duration of benefits will be extended up to 13 weeks for unemployed workers who exhaust their benefits under regular programs. These extended payments will be financed through advances from the general budget to the trust fund. They will be repaid later from the proceeds of the temporarily increased Federal unemployment tax.

$215 million for aid to the dependent children of the unemployed—to help relieve distress and prevent the enforced breaking up of families.

$214 million for the Housing and Home Finance Agency, covering the cost of the programs advanced by the President for low-cost housing, urban renewal, college housing loans, public facility loans, and housing for the elderly.

$95 million for veterans benefits, consisting of $65 million for the selective cost-of-living increases and adjustments in compensation payments to service-disabled veterans proposed by the President and $30 million for direct housing loans.

The proposed increases in expenditures can be expected to generate an increase in economic activity and in incomes over the next year, which will, in turn, yield an increase in tax revenues, estimated in the President's message at $900 million.

Thus, the $2.3 billion increase in 1962 expenditures proposed by the President is less than the originally estimated surplus of $1.5 billion plus revenue increases of $900 million from the accelerated economic recovery that the President's program could be expected to generate. The new budgetary proposals for 1962 have, of course, as stated in the President's state of the Union message, been kept within this limit intentionally. Of themselves, except for the additional defense needs, they would not unbalance the budget submitted to the Congress by the preceding administration.

However, it is now apparent that both the expenditure and revenue estimates in the January budget were in error.

The January budget estimate of expenditures for farm price supports and other activities of the Commodity Credit Corporation was based on assumptions as to output, domestic consumption, and exports of farm commodities which now appear to be optimistic. On this count alone, $249 million needs to be added to the earlier estimate. Interest on the public debt, considering only the program set forth in the January budget but allowing for the presently expected shortfall in revenues, is now estimated to rise by about $100 million over the January figure. Taking account of a number of other increases and decreases in expenditure estimates, the total net effect of reestimating the January program is to increase the 1962 expenditure estimate by $372 million.

Federal revenues in fiscal 1962 will depend largely on the course of the economy during the calendar year 1961. The Treasury and the Council of Economic Advisers now tell us that the economic assumptions underlying the budget sent to the Congress in January would have been unrealistically optimistic if the Government program advanced in that budget has been adopted. In fact, if the budget expenditure program recommended in January had prevailed, a revenue estimate of $80.5 billion for fiscal 1962 would have been closer to the mark than the $82.3 billion predicated.

Allowing for the improvement in econmic activity that the present budget proposals would generate, budget receipts for fiscal 1962 are now estimated at $81.4 billion. While corporation income taxes are not expected to fall significantly below the January estimate, individual income taxes and excise taxes are now expected to be substantially lower.

The present estimate of $81.4 billion of budget receipts for 1962 assumes the extension of corporate income and excise tax rates and the adoption of the President's proposal to prevent the diversion of taxes from the general fund to the highway trust fund.

All the revisions in the January budget estimates for 1962, except for the defense program, are summarized in table 2. As that table clearly shows, a budget deficit is now in prospect for 1962, and that deficit will be the consequence of the overestimation of revenues and underestimation of expenditures in the January budget.

TABLE 2.—*Estimated budget totals, fiscal 1962*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$82,333	$80,865	$1,468
Recommended program changes, except defense, and added revenue from increased economic activity generated by new proposals	900	2,322	−1,422
Total	83,233	83,187	+46
Necessary revisions in estimate for January budget program (not related to new proposals)	−1,800	+372	−2,172
Revised estimate, budget totals	81,433	83,559	−2,126

NOTE.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300 million.

RECOMMENDED REVISIONS IN TRUST FUND PROGRAMS

A number of the programs recommended in the President's messages would be financed through trust funds, outside of the regular budget. They include mainly (1) improvements in the existing system of old-age, survivors, and disability insurance, (2) provision of medical care for the aged on a self-financed basis through the old-age, survivors, and disability insurance system, (3) a speedup in the payment of veterans life insurance dividends, and (4) increased funds for the Federal-aid highway program.

Table 3 sets forth the revisions in the estimates of trust fund receipts and expenditures.

The effect of the temporary extended unemployment compensation program on the budget has already been mentioned. Advances from the general budget to the trust fund and trust fund payments are shown in table 3. However, pending the determination of firm proposals for strengthening the permanent Federal-State unemployment insurance system, no estimates have been included for the revision of the permanent program.

The revisions recommended by the President for old-age, survivors, and disability insurance benefits will add $1.1 billion to trust fund expenditures in fiscal year 1962. To finance these increased payments, tax increases of one-quarter of one percent each on employers and employees are to go into effect on January 1, 1963. The inclusion of medical care for the aged in the social security system will not affect trust fund expenditures until fiscal year 1963. The proposed increase in the covered wage base from $4,800 to $5,000 would be effective January 1, 1962, and would affect trust fund revenues only slightly in fiscal 1962; a further tax rate increase of one-quarter of 1 percent on employers and workers would go into effect on January 1, 1963.

As a result of the early payment of dividends under the veterans life insurance system, trust fund expenditures of $105 million will be shifted from fiscal year 1962 into fiscal 1961.

The entire balance of Federal-aid highway funds scheduled for this fiscal year has been made available to the States. Efforts are underway to obtain the cooperation of the States in effecting a speedup to get highway projects under construction more rapidly, but no change has been made in the January estimate of highway trust fund payments for 1961. A proposed expansion of the presently authorized Federal-aid highway program, together with the necessary increase in taxes to support it, was transmitted to the Congress earlier this month. If the increases recommended are promptly enacted, further acceleration of highway construction will result in increased trust fund payments in 1962 of $60 million and increased receipts of $15 million.

A much larger than expected volume of mortgage sales early this calendar year has reduced by $731 million the net expenditures for 1961 estimated in January for the secondary market operations of the Federal National Mortgage Association. No further substantial sales are anticipated under present policies, however, and the secondary market operations are being used to support a reduction in the interest rate from 5¾ percent to 5½ percent on loans issued by the Federal Housing Administration.

TABLE 3.—*Estimated trust fund expenditures and receipts*

[Fiscal years; in millions]

	Expenditures		Receipts	
	1961	1962	1961	1962
Jan. 16, 1961, budget program	$24,102	$25,155	$24,239	$25,189
Administrative actions and recommended program changes:				
Old-age, survivors, and disability insurance:				
Liberalization	55	1,105		[1] −21
Medical care				40
Unemployment trust fund:				
Temporary unemployment compensation and employment service expansion	509	453	564	446
Extension of railroad unemployment benefits	8	15	24	
Veterans life insurance: Accelerated dividend payments	105	−105	[1] −1	
Federal-aid highways		60		15
Federal National Mortgage Association purchases (net)	200			
Total program changes	877	1,528	587	480
Necessary revisions in estimate for Jan. 16, 1961, budget program (not related to new proposals):				
Unemployment trust fund	300			
Federal National Mortgage Association purchases (net)	−731			
Revised estimate, trust fund totals	24,548	26,683	24,826	25,669

[1] Reduced interest receipts.

RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

Because trust fund and certain other transactions are not included in the budget totals, and because the budget and trust fund totals include several billions of dollars of intragovernmental transactions, a consolidation of all accounts—excluding intragovernmental receipts and payments—is necessary to show the flow of money between the Federal Government and the public. A summary derivation of these consolidated cash totals is shown in table 4.

TABLE 4.—*Estimated receipts from and payments to the public*

[Fiscal years; in millions]

Description	1961		1962	
	January estimate	Current estimate	January estimate	Current estimate
Receipts from the public:				
Budget receipts	$79,024	$78,524	$82,333	$81,433
Trust fund receipts	24,239	24,826	25,189	25,669
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Seigniorage on silver	63	63	82	82
Total	99,005	98,504	103,145	102,301
Payments to the public:				
Budget expenditures	78,945	80,693	80,865	83,559
Trust fund expenditures	24,102	24,548	25,155	26,683
Government-sponsored enterprise expenditures (net)	−196	−196	421	421
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Excess of interest accruals over payments, etc	725	725	314	314
Total	97,931	99,537	101,832	105,630
Excess of receipts over payments (+) or payments over receipts (−)	+1,074	−1,033	+1,313	−3,329

NOTE.—Detail may not add to totals because of rounding.

FISCAL POLICY: THE LONG RUN

In this first appearance before the Joint Economic Committee, I should like to say a few words about the basic approach of the new administration to fiscal policy.

First, let me say something about the long-run trend in Federal receipts and expenditures. This is a growing country with an expanding labor force, continually better technology, and a steadily increasing capacity to produce. In these circumstances, as the President said in his budget and fiscal policy message, "Federal revenue and expenditure levels must be adequate to meet effectively and efficiently those essential needs of the Nation which require public support as well as, or in place of private effort." The United States has very large resources to meet its obligations of world leadership and, at the same time, to achieve major advances in well-being at home. The question at any given time, within the total of the Nation's capacity, is one of judgment as to the relative importance of the various alternative public and private uses of resources.

At the present time, the President has proposed that we should move ahead along certain lines—to improve the education, health, and welfare of our people, to conserve and develop our natural resources, to provide needed public facilities, to increase scientific research and promote technological progress, and to strengthen free world defenses. It would be a serious error of public policy, as well as false economy, to reject these public programs on an arbitrary assumption that "we cannot afford them." This Nation can afford higher expenditures, public or private, up to the limit of its capacity to produce—a limit it has not approached for several years. The question is one of relative importance. Each expenditure must be evaluated, in the President's words, "in terms of our national needs and priorities * * * and compared with the urgency of other budgetary requirements." The relevant criterion in determining the desirability of a proposed use of resources for a public purpose is its value to the country in comparison to the value of using the same resources for other purposes, public or private.

Meeting our national needs responsibly in the years ahead may well mean increased rather than reduced Federal spending, until and unless we can arrive at a satisfactory agreement for the reduction of world armaments. As a matter of fact, budget studies published by the preceding administration, to which the President referred in his budget message, indicate that under its policies, and under existing laws and programs, annual Federal budget expenditures would be likely to increase by $15 to $20 billion in the coming decade, and annual trust fund outlays by another $10 to $15 billion.

By far the largest proportion of Federal Government purchases of goods and services is for national security purposes. The future level of expenditures for national security will depend in large part upon world events in relation to U.S. interests, commitments, and risks. If there is no worsening of international tensions, and if changes in military technology continue along the lines that seem quite possible, the increase in defense expenditures in the years ahead might be moderate, and the percentage of the gross national product needed for defense purposes might decline, as it has in the past few years. It is also quite possible, of course, that world tensions may increase, or technological changes of a different type may come along, which would require a larger share of the national product for defense purposes.

If it proves possible to meet national security needs with a declining share of the national product, the needs of the Nation for education, health, community development, scientific research, development of natural resources, and other programs might be met without an increase, and perhaps with a decrease in the share of the Nation's growing output of goods and services used by the Federal Government.

On the other hand, Federal transfer payments (such as social security benefits and other Federal programs that do not involve a Government claim on the Nation's current output of goods and services) and grants to States will probably continue to grow, and perhaps also rise as a proportion of the gross national product. These disbursements as well as direct purchases of goods and services will have to be taken into account in determining the Government's total revenue needs.

As stated in the President's economic message of February 2, the American economy was capable in calendar 1960 of an output of $535 billion, 6 percent above the $503.5 billion actually produced. Moreover, our economic potential now grows at a rate of at least 3.5 percent per year. At this rate, the gross national product would increase to more than $750 billion by 1970 in present prices. At today's tax rates, this growth would yield an increase in budget revenues from $77.8 billion in fiscal 1960 to approximately $120 billion in fiscal 1970. These are minimum estimates. With proper public and private policies, we should be able to achieve a significantly higher rate of growth in national output.

The President's economic and fiscal recommendations have been prepared with this objective in mind. The expenditures proposed are an important part of a national effort to close the gap between our actual and our potential output and to achieve adequate economic growth. This is particularly true of capital expenditures of Government that are needed to reinforce private capital expenditures, and expenditures to improve the quality and productivity of our human resources. These expenditures are as essential to economic growth as are private investment outlays.

FISCAL POLICY: THE SHORT RUN

Within the framework of long-run goals, fiscal policy should be adapted to the needs of the current economic situation. "Federal expenditure and revenue programs," to use the President's words, "should contribute to economic growth and maximum employment within a setting of reasonable price stability." Moreover, as the President noted, because of the limits which the current balance of payments deficit places on the exercise of monetary policy, fiscal policy must assume a heavier burden of responsibility for economic stability and growth.

Certain Federal expenditures automatically exercise a contracyclical influence. Unemployment compensation benefits, and old-age and survivors insurance payments (reflected mainly in trust fund accounts rather than in the regular budget), for example, tend automatically to rise in times of economic decline and to fall, or in the case of OASI benefits to rise less rapidly, in times of boom.

Most Federal expenditures, however, exhibit no such automatic contracyclical pattern, and it is necessary to make judgments as to their magnitude and timing in relation to the current economic outlook. Federal programs differ greatly, of course, in the degree to which they can or should be altered in response to fluctuations in business activity. Defense expenditures, to take a major example, should be set at the level needed, no more and no less, to provide adequately for the defense of this Nation. Their timing can sometimes be adjusted, within limits, for economic reasons, but their magnitude should be determined by defense needs. The same is true of expenditures to enact and enforce legislation, to assure justice, to protect our people against crime and internal violence, to represent the interests of citizens of this country in countries abroad, and to provide numerous other services of Government.

At the same time, there are activities of Government which may or may not be worth undertaking, depending on the extent to which the Nation's resources are being utilized. If private demands are high, and productive resources are being pushed to capacity operations with consequent upward price pressures, then Government should retrench. Less urgent projects should be deferred. On the other hand, when private demands are slack, and productive resources are idle, such deferred public projects should be undertaken and can help economic recovery while filling a specific public need. Moreover, public works projects—especially those with a fairly short completion time—can be accelerated in times of low employment and retarded in times of high employment. The procurement of certain supplies and equipment can be speeded up when private spending is declining and slowed down when private spending is rising without significantly affecting the efficiency of the Government's inventory and supply systems. It was for this purpose that the President directed, a few weeks ago, a speedup in construction and procurement already funded.

Federal expenditure programs can be increased or decreased for the purpose of offsetting business cycle movements, however, only within limits. Public expenditure programs typically cannot be turned on and off like a faucet. The authorization and appropriation processes are inevitably time consuming. Engineering, planning, and procurement arrangements also take time. This problem of an inevitable timelag is less serious now, when there is persistent slack in our economy, than it would be in more favorable circumstances. Programs of intrinsic merit can be initiated now without fear that their impact will be felt too late, when it is not needed. But steps to speed up public expenditure programs must always be taken with due care, lest waste and inefficiency result.

On the revenue side of the budget, tax collections, even with no change in tax rates, respond fairly promptly and more than proportionately to fluctuations in the general level of employment and incomes. Although this sensitivity to the business cycle is probably a reflection of other tax objectives rather than of conscious design, it is nevertheless desirable. We have learned from long experience that an attempt exactly to match tax revenues to expenditures each year, regardless of the level of business activity, would be not only extremely difficult, but would be positively harmful.

A decline in revenues relative to expenditures in times of falling economic activity means that the Federal Government is contributing to recovery by reducing the net amount of purchasing power that it is siphoning out of the private income stream. Thus consumers and businesses have more funds to spend than they would otherwise have. Conversely, in times of boom and inflationary pressures arising from excess private demand, a rise in Federal revenues has the opposite effect; it siphons some of the excess purchasing power out of the private income stream. In these ways, the automatic response of tax revenues to economic activity contributes to economic stabiliy.

The sensitivity of Federal revenues and payments to overall economic conditions helps to give the economy a built-in stability, valuable in arresting recessions and checking inflationary booms. But built-in stabilizers can at best do only part of the job. The automatic response of the tax system restores a fraction, but only a fraction, of the loss of income and demand in recession. Similarly, it can do no more than offset part of the increases in spending in an inflationary period.

The automatic stabilizers leave plenty of room for discretionary policies of economic stabilization, both fiscal and monetary. A major surge in private spending—such as that which occurred shortly after the outbreak of the Korean war—calls for an increase in tax rates; and indeed the Congress then acted promptly and wisely to provide such an increase. Conversely, a serious or prolonged decline in economic activity relative to the Nation's potential would call for a reduction in tax rates.

As the Chairman of the Council of Economic Advisers emphasized in his testimony before this committee, we must be alert not to permit tax and expenditure policies to stabilize employment and production at levels far short of full capacity. As the capacity of the economy grows, potential revenues grow even faster. A tax and expenditure structure that yields a deficit in a given year could well yield a surplus several years later when, even though the rate of unemployment is the same, the output of the economy is larger. Tax and expenditure programs should be adjusted from time to time to assure that automatic surpluses do not develop under circumstances when they would be harmful. When the economy is operating at its full potential, and when investment funds are in short supply, a surplus contributes to economic growth by permitting some retirement of public debt, thus releasing savings for needed investment in private plant and equipment. But a surplus while unemployment is high, resulting from deliberate action or simply from the automatic response of the tax structure to growth in the Nation's productive potential, can of itself prevent the attainment of full employment. Under such circumstances, a budget deficit is clearly essential to economic recovery.

THE BUDGET AND THE BALANCE OF PAYMENTS

The magnitudes of our Government expenditures abroad are substantial. The President has directed that a close review of all governmental activities be made in order to economize on the use of dollars abroad. But with the best efforts to economize, we can anticipate that our total foreign expenditures will remain large until major disarmament becomes possible.

It would be a serious error to eliminate essential expenditures solely for foreign exchange reasons. As stated in the President's message on balance of payments and gold, we must not try to strengthen our balance of payments at the cost of either military operations abroad that are required for the safety of our people or of economic progress in the less developed countries. There are other and better ways of insuring a reasonable balance in our basic economic relationships with foreign countries.

It is not easy to assess the impact of Federal expenditures on the U.S. balance of payments. For one thing, expenditures for foreign goods and services have taken place within total agency programs and, with few exceptions, have not been shown separately in the budget. Now that the need for estimates of foreign exchange expenditures is more apparent, the Treasury and the Budget Bureau are taking steps to identify direct outlays for foreign goods and services, and as the President directed in his balance of payments message, these will be considered in making budgetary decisions. There is, however, a deeper problem. The impact of Federal outlays on the Nation's balance of payments is not measured by the direct costs of foreign purchases. There is the additional question of what happens to the dollars spent abroad. A direct outlay for a foreign purchase which results in an immediate offsetting purchase of American products has, of course, no net effect whatever on the balance of payments. It is necessary therefore to be very careful in judging the relationships between the budget and the balance of international payments.

EFFICIENCY AND ECONOMY IN GOVERNMENT SPENDING

It is an essential element of fiscal policy that expenditures be made in the most efficient way possible. As the President said in his budget message, "We must not allow expenditures to rise of their own momentum, without regard to value received." "It is my determined purpose," the President said, "to be a prudent steward of the public funds—to obtain a dollar's worth of results for every dollar we spend."

The Federal budgeting process is not only one of deciding which programs shall be supported and which denied. It is also a process of maximizing results per dollar of funds spent. I regard this as a major and continuing responsibility of the Budget Bureau. We must lead a continuing, Government-wide effort to increase efficiency and reduce waste.

The existence of such waste in recent years has, I know, been documented in studies carried out by congressional committees, including a subcommittee of this committee. I hope it will be possible for us to continue to benefit from the interest of these committees, and that we can work together to bring about greater efficiency and economy of operation in all Government activities.

There are certain legislative actions which I hope will be taken this year to assist in this effort. Appropriated funds can be spent most efficiently if the Department head has authority to exercise some discretion in assigning funds and personnel within his agency. The President has asked the Congress, in enacting appropriations for each Department and agency, to provide the necessary authority to transfer within his agency a modest amount of the funds available for operating expenses, subject to control by the Bureau of the Budget through the regular apportionment process. Further, enactment of the bill (already passed by the Senate) giving the President authority to transmit reorganization plans to the Congress will strengthen the arm of the President in seeking efficiency and economy.

At the same time, I think it is clear that the task of driving out waste and improving efficiency is primarily a task of intelligent and continuous good management, acting day after day and month after month to find opportunities for improvement and put those improvements into effect. This is principally a matter of executive branch leadership, and I know—and the President knows—that a tremendous amount can be done within the authority already given by the Congress. I can assure you that the President takes a keen personal interest in this matter, and that we intend to keep steady pressure on every agency, and to follow up every lead that may promise better and cheaper results in the expenditure of public funds. The President has arranged for the continuing services of a group of distinguished consultants, including Robert Lovett and Don K. Price, to assist in the effort to achieve steady improvement in the effectiveness of Government operations. We expect to continue to give this matter top priority.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., March 27, 1961.

DETAILS IN SUPPORT OF THE STATEMENT OF THE DIRECTOR OF THE BUREAU OF THE BUDGET

Total budget expenditures for fiscal 1961 are now estimated to be $80.7 billion, $1.7 billion higher than the January budget estimate of $78.9 billion. For fiscal 1962, budget expenditures are estimated to total $83.6 billion, which is $2.7 billion more than estimated in the January budget. Revised estimates of expenditures and needed new obligational authority for each functional program area in 1961 and 1962 are compared with the January budget estimates in tables 5 and 6. (The estimates are shown for each major agency in tables 16 and 17.) The figures for fiscal year 1962 exclude any changes to be proposed in the President's message on national defense, which is expected this week.

The largest single increase in estimated 1962 expenditures is for labor and welfare programs, which are expected to increase by $1,261 million, mainly for aid to education and for the temporary extended unemployment benefit program. Expenditures in 1962 for agriculture and agricultural resources are now expected to be $642 million higher than the January estimate; this increase reflects an upward revision in estimated disbursements for the program proposed by the preceding administration as well as the new proposals advanced in recent weeks by the President. An increase of $443 million is estimated for commerce and housing programs, and space technology, mainly for housing programs.

TABLE 5.—*Budget expenditures by function*

[Fiscal years; in millions]

Function	1961		1962	
	January estimate	Current revision	January estimate	Current revision
Major national security	$45,930	$46,720	$47,392	[1] $47,472
International affairs and finance	2,310	2,435	2,712	2,826
Commerce, housing, and space technology	3,784	3,950	3,371	3,814
Agriculture and agricultural resources	4,936	4,905	5,101	5,743
Natural resources	1,951	2,045	2,138	2,162
Labor and welfare	4,483	5,089	4,759	6,020
Veterans' services and benefits	5,227	5,239	5,296	5,301
Interest	8,993	8,993	8,593	8,693
General government	1,982	1,968	2,071	2,095
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,226
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	83,559

[1] Excludes any program changes in the military functions of the Department of Defense to be proposed in President's defense message.

NOTES.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300 million.
Detail may not add to totals because of rounding.

TABLE 6.—*New obligational authority by function*

[Fiscal years; in millions]

Function	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Major national security	$45,912	$45,975	$46,278	[1] $46,108
International affairs and finance	3,207	3,563	3,102	3,210
Commerce, housing and space technology	4,612	5,460	3,993	4,900
Agriculture and agricultural resources	4,696	7,238	4,605	5,285
Natural resources	2,049	2,050	2,012	2,109
Labor and welfare	4,937	6,171	5,025	6,442
Veterans services and benefits	5,438	5,438	4,963	5,003
Interest	8,993	8,993	8,593	8,693
General government	2,073	2,102	2,096	2,120
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	84,072

[1] Excludes any program changes in the military functions of the Department of Defense to be proposed in President's defense message.

NOTE.—Detail may not add to totals because of rounding.

Major national security.—Developments to date indicate that the January estimate of 1961 expenditures for the military functions of the Department of Defense, $41.5 billion, was an underestimate. A more realistic figure is $42.2 billion, an increase of $744 million. Part of this increase is offset by reductions of $200 million in the estimate of military assistance expenditures and $10 million for stockpiling expenditures, compared with the figures included in the January budget. Apart from reestimates, an increase of $256 million is estimated in 1961 expenditures for the military functions of the Department of Defense, primarily as a result of accelerations directed by the President. Of this increase, $175 million reflects speedier contract payments due to the lifting of the 20 percent holdback restriction that was placed on procurement contracts in 1957. The remainder is mainly for acceleration of the Polaris missile programs and the stepup in the rate of airlift modernization.

In total, the result of the reestimates of the January budget figures and the actions of the President is that budget expenditures for major national security programs in 1961 are now estimated to be $46.7 billion, an increase of $790 million over the January estimate.

For fiscal year 1962, the January budget program for the military functions of the Department of Defense has been reestimated upward by $190 million, reflecting a higher operating level consistent with the revised estimate for 1961. Partly offsetting this increase are declines of $100 million in military assistance expenditures and of $10 million for atomic energy programs. The 1962 figures do not include the effects of the President's new recommendations concerning defense, to be transmitted to the Congress shortly.

TABLE 7.—*Major national security*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$45,930	$47,392	$45,912	$46,278
Reestimates of budget program:				
Department of Defense, military:				
Military functions	744	190		
Military assistance	−200	−100		
Stockpiling and defense production	−10			
Revised estimate, January budget program	46,464	47,482	45,912	46,278
Proposed program changes:				
Department of Defense, military:				
Military functions	256	(1)	63	(1)
Military assistance				−200
Atomic Energy Commission (new obligational authority is for linear electron accelerator)		−10		30
Current estimate	46,720	47,472	45,975	46,108

[1] Excludes any program changes to be proposed in President's defense message.

International affairs and finance.—Compared with the January budget, expenditures for international programs are currently estimated to be $2,435 million in fiscal year 1961, an increase of $125 million, and $2,826 million in fiscal 1962, an increase of $114 million.

For 1961, $50 million of the increase represents a reestimate of the net expenditures of the Export-Import Bank, reflecting the current expectation that loan disbursements will be higher and loan repayments lower than estimated in the January budget. Another $50 million, similarly, reflects a reestimate of mutual security (economic and contingencies) expenditures, again based on the latest information available. It is estimated that $25 million will be spent this year under the $100 million supplemental appropriation requested for Chilean reconstruction; no estimate for this purpose was carried in the January budget.

The estimated increase in expenditures for fiscal year 1962 includes (1) $50 million representing a reestimate of the expenditures for the Inter-American program for social progress, (2) $50 million for the Chilean reconstruction program, and (3) $14 million for the State Department (mainly for Africa) and U.S. Information Agency (expansion of activities in Africa and Latin America).

New expenditures of $20 million for the Peace Corps can be included within the amounts previously estimated for foreign economic assistance, because of the expectation that other aid disbursements will decline temporarily as emphasis shifts from support aid to planned investment programs abroad.

TABLE 8.—*International affairs and finance*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$2,310	$2,712	$3,207	$3,102
Reestimates of budget program:				
Export-Import Bank	50			
Mutual security—economic and contingencies	50			
Inter-American program for social progress		50		
Revised estimate, January budget program	2,410	2,762	3,207	3,102
Proposed program changes:				
Chilean reconstruction	25	50	100	
Emergency famine relief (Commodity Credit Corporation)			256	−115
Mutual security—economic and contingencies (including Peace Corps)		(1)		200
State Department (mainly for Africa)		6		12
U.S. Information Agency		8		11
Current estimate	2,435	2,826	3,563	3,210

1 If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded expenditures in 1962 would be reduced by about $300 million

Commerce, housing, and space technology.—The current outlook is for an increase over the January budget estimate of $166 million, to $3,950 million, in 1961 expenditures for commerce and housing programs, and for space technology. The major change is in the postal deficit, reflecting the now obvious fact that postal rate increases will not be enacted effective April 1, 1961, as assumed in the January budget estimate. Expenditures for Veterans' Administration direct housing loans from funds already available will apparently run some $74 million higher than estimated in January as a result of continued high demand and improved loan processing procedures. These and other increases are offset in part by a downward revision of $50 million in the January estimate of expenditures for space programs.

Budget expenditures in 1962 are now estimated to increase by $443 million over the January estimate, from $3,371 million to $3,814 million, largely for housing programs, for redevelopment of distressed areas, and for acceleration of research and development in selected space activities. In addition to the legislative proposals for housing programs, made in the President's message to the Congress of March 9, the revised estimate reflects accelerated activity under prior authorizations in public facility loans, college and veterans housing loans, and urban renewal.

The current estimate of 1962 expenditures assumes that the Congress will act, as the President is recommending, to increase postal rates effective July 1, 1961, by enough to eliminate the postal deficit now in prospect for 1962 under present rates.

TABLE 9.—*Commerce, housing, and space technology*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$3,784	$3,371	$4,612	$3,993
Reestimates of budget program:				
Post Office	140		148	
Veterans' Administration direct housing loans	74			
Office of Civil and Defense Mobilization	11			
Federal Aviation Agency	−10	3		12
National Aeronautics and Space Administration	−50			
Housing and Home Finance Agency	−30			
Other	−10			
Revised estimate, January budget program	3,909	3,374	4,760	4,005
Proposed program changes:				
Housing and Home Finance Agency:				
College housing loans	11	45	100	150
Low-cost housing		65		350
Urban renewal		54	600	−300
Public facility loans		30		50
Housing for the elderly		10		50
Other		10		120
Farm housing loans	30	45		225
Veterans' Administration direct housing loans		30		
National Aeronautics and Space Administration		85		126
Area redevelopment		40		42
Federal Aviation Agency		10		47
Coast Guard		8		13
Department of Commerce (scientific research and other programs)		8		23
Current estimate	3,950	3,814	5,460	4,901

Agriculture and agricultural resources.—Budget expenditures for agricultural programs are now expected to be $4,905 million in 1961 and $5,743 million in 1962. The present estimate for 1961 is $31 million less than the January estimate, primarily because of a $423 million reduction in the estimated expenditures of the Commodity Credit Corporation for farm price supports and related activities. Largely offsetting this decrease are program changes made by this administration. The largest increases are $225 million in Commodity Credit Corporation expenditures under the new feed grain legislation and $118 million for the domestic distribution of increased amounts of surplus foods; another $34 million is for increased farm ownership and operating loans over the level contemplated in the previous administration's program.

For the fiscal year 1962, total expenditures are now estimated to be $642 million higher than the January estimate. It now appears that the January budget program for the Commodity Credit Corporation was underestimated by $249 million. Even at the low support levels assumed in the 1962 budget, lower exports, reduced domestic consumption, and higher crop yields than were estimated when the January budget calculations were made can now be expected to increase outlays for farm price and income supports and other activities. A larger increase of $393 million in 1962 expenditures will result from program changes proposed by the President, including those described in his agricultural message of March 16. Details are shown in the following table:

TABLE 10.—*Agriculture and agricultural resources*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$4,936	$5,101	$4,696	$4,605
Reestimates of budget program:				
Commodity Credit Corporation	−423	249		
Soil bank program	11			
Revised estimate, January budget program	4,524	5,350	4,696	4,605
Proposed program changes:				
Commodity Credit Corporation (price supports: cotton, peanuts, rice, and milk; surplus food distribution abroad and other)	225	164	2,542	507
Surplus food distribution (domestic)	118	100		
Food stamp pilot program	4	50		
Farm ownership and operating loans	34	77		84
Rural Electrification Administration loans		15		100
Other		−13		−11
Current estimate	4,905	5,743	7,238	5,285

Natural resources.—Expenditures in the fiscal year 1961 for natural resources programs are now estimated to be $94 million above the January budget estimate. The current estimate of $2,045 million includes the expenditure of $69 million by the Forest Service to pay for those forest lands of the Klamath Indians which are not sold to competitive bidders by April 1, 1961. The January budget provided for a supplemental appropriation for 1961 to cover this payment, which is required by law, but proposed unjustifiably to defer the payment until fiscal year 1962. This shift of expenditures from 1962 back to 1961 offsets a number of expenditure increases proposed by the President for 1962, so that the total rise in natural resources expenditures in the coming fiscal year as compared with the budget estimate is $24 million.

The increases for 1962, as shown in the following table, are for certain activities which are being accelerated, particularly for development of our national forests, parks, and seashore and recreational areas; for construction of Indian schools; and for starting some new water resource projects of the Corps of Engineers. In addition, the Bureau of Reclamation will initiate construction of additional transmission lines and will continue construction of one new project which is being started, at the direction of the President, in fiscal 1961. These and other measures set forth in the President's message of February 23 will make possible greater progress toward the Nation's long-range resource conservation and development goals.

TABLE 11.—*Natural resources*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$1,951	$2,138	$2,049	$2,012
Reestimates of budget program:				
Klamath Indian land purchase	69	−69		
Corps of Engineers, construction	25	20		
Tennessee Valley Authority	−15			
Other	−10			
Revised estimate, January budget program	2,020	2,089	2,049	2,012
Proposed program changes:				
Bureau of Indian Affairs (Indian welfare and education)	1	14		21
National Park Service (Mission 66 and seashore areas)	4	11		20
Other Interior Department	5	8	1	11
Forest Service		21		21
Corps of Engineers, construction	15	17		22
Tennessee Valley Authority		2		2
Current estimate	2,045	2,162	2,050	2,109

Labor and welfare.—Budget expenditures for education, labor, health, and welfare programs in 1961 are now estimated to be $5,089 million, $606 million more than the January estimate. For 1962, the current estimate is $6,020 million, an increase of $1,261 million from the January budget.

Almost all the increase in 1961 is for temporary extended unemployment benefits and aid to dependent children of the unemployed. Budget expenditures of $574 million are estimated for 1961 for the temporary unemployment compensation program, representing an advance to the unemployment trust fund. This amount includes extended benefits for unemployed railroad workers, and for Federal employees and ex-servicemen. Disbursements to the States under this temporary program will be made from the trust fund in 1961 and 1962, and the advance will be repaid to the Treasury in later years from increased proceeds of the Federal unemployment tax.

The largest single expenditure increase estimated for 1962 is $500 million for the elementary and secondary school program proposed in the President's education message to the congress on February 20. Another $440 million is for the 1962 advance to the unemployment trust fund for the temporary unemployment compensation program. The proposed legislation to aid dependent children of the unemployed is estimated to entail expenditures of $215 million in 1962. Proposed legislation and budgetary increases in other programs for health, science and scientific research, education, and welfare would increase spending in 1962 by an additional $106 million. This estimate reflects an anticipated reduction of $52 million in the January estimate of budget expenditures for public assistance, which would result from enactment of the proposals for liberalizing the old-age, survivors, and disability insurance program and for providing medical care for the aged through the social security system.

TABLE 12.—*Labor and welfare*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$4,483	$4,759	$4,937	$5,025
Reestimates of budget program:				
National Science Foundation	−10	−10		
Other		−1		−1
Revised estimate, January budget program	4,473	4,748	4,937	5,024
Proposed program changes:				
Temporary extended unemployment compensation	550	440	990	
Temporary extended railroad unemployment benefits	24		24	
Advances for employment security administration	14	−10	18	20
Elementary and secondary education		550		667
Aid to higher education		21		332
Aid to federally affected schools		−5		8
National defense education		32		82
Aid to dependent children of the unemployed	28	215	30	226
OASDI liberalization and medical care (budget effect)		−52		−52
Public Health Service:				
Medical education and research		9		34
Community health activities		9		24
Water and air pollution control		12		52
Other Public Health Service (mainly National Institutes of Health)		38	1	80
Maternal and child welfare grants		10		10
National Science Foundation, grants for basic research and science education		29		65
School lunch program		10		10
Special milk program		9	171	−161
Vocational rehabilitation and other		9		21
Current estimate	5,089	6,020	6,171	6,442

Veterans services and benefits.—Budget expenditures for veterans programs are currently estimated to be $5,239 million in fiscal 1961, $12 million higher than estimated in January, and to be $5,301 million in 1962, a rise of $5 million from the January budget estimate. The revision for 1961 is a reestimate of the January budget program, based on actual trends to date. The estimated 1962 expenditures reflect the net effect of (1) a downward reestimate of the January figures, mainly due to a lesser than anticipated impact of the Veterans Pension Act of 1959, which liberalized eligibility requirements and raised pension rates for many pensioners on the rolls, and (2) a proposed selective increase in compensation rates for veterans with severe service-connected disabilities to offset rises in the cost of living since rates were last adjusted in 1957 and to adjust some rates which are out of line.

TABLE 13.—*Veterans' services and benefits*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$5,227	$5,296	$5,438	$4,963
Reestimates of budget program:				
Veterans' compensation and pensions		−40		−25
Other Veterans' Administration programs	12	−20		
Revised estimate, January budget program	5,239	5,236	5,438	4,938
Proposed program changes: Selective increase in compensation rates		65		65
Current estimate	5,239	5,301	5,438	5,003

Interest.—Expenditures for interest in 1962 are now estimated to be $8,693 million, an increase of $100 million over the January estimate. This is due to increased interest on the public debt growing mainly out of the heavier borrowing in 1961 and 1962 now expected.

TABLE 14.—*Interest*

[Fiscal years; in millions]

Description	New obligational authority and expenditures	
	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$8,993	$8,593
Reestimates of budget program: Interest on the public debt		100
Current estimate	8,993	8,693

General government.—Expenditures in fiscal year 1961 for general government activities are currently estimated to be $1,968 million, which is $14 million less than estimated last January. For fiscal year 1962, the current estimate is $2,095 million, an increase of $24 million over the estimate in the January budget. The major changes in the 1961 estimate are for higher unemployment compensation payments to ex-servicemen and former Federal employees, more than offset by downward revisions in the estimates for the General Services Administration and other agencies in this category.

TABLE 15.—*General government*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$1,982	$2,071	$2,073	$2,096
Reestimates of budget program:				
Unemployment compensation for Federal employees and exservicemen	33		33	
General Services Administration	−42			
Other	−25		−6	
Revised estimate, January budget program	1,948	2,071	2,100	2,096
Proposed program changes:				
Judgeship bill		4		4
Treasury Department		17	1	17
Other	20	3	1	−3
Current estimate	1,968	2,095	2,102	2,120

TABLE 16.—*Budget expenditures by major agency*

[Fiscal years; in millions]

Agency	1961		1962	
	January estimate	Current revision	January estimate	Current revision
Legislative branch and the judiciary	$208	$200	$203	$207
Executive Office of the President	61	72	92	92
Funds appropriated to the President:				
Mutual security, economic and contingencies	1,675	1,725	1,875	1,875
Other	43	58	75	175
Independent offices:				
Atomic Energy Commission	2,660	2,660	2,680	2,670
Export-Import Bank	−100	−50	−4	−4
Federal Aviation Agency	640	630	730	743
National Aeronautics and Space Administration	770	720	965	1,050
Veterans' Administration	5,314	5,400	5,369	5,404
Other	770	759	676	704
General Services Administration	442	420	496	498
Housing and Home Finance Agency	544	525	728	942
Department of Agriculture	5,739	5,807	5,782	6,440
Department of Commerce	511	511	566	614
Department of Defense, military:				
Military functions	41,500	42,500	42,910	[1] 43,100
Military assistance	1,700	1,500	1,750	1,650
Department of Defense, civil	986	1,015	984	1,021
Department of Health, Education, and Welfare	3,716	3,744	4,005	4,798
Department of the Interior	785	785	873	906
Department of Justice	285	285	294	296
Department of Labor	295	892	223	654
Post Office Department	786	926	63	63
Department of State	260	260	345	351
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	965	965	1,095	1,120
District of Columbia	48	42	66	66
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,226
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	83,559

[1] Excludes any program changes to be proposed in President's defense message.

NOTE.—Detail may not add to totals because of rounding.

TABLE 17.—*New obligational authority by major agency*

[Fiscal years; in millions]

Agency	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Legislative branch and the judiciary	$176	$176	$180	$184
Executive Office of the President	72	72	116	116
Funds appropriated to the President:				
Mutual security, economic and contingencies	2,131	2,131	2,200	2,400
Other	507	607	13	13
Independent offices:				
Atomic Energy Commission	2,781	2,781	2,598	2,628
Federal Aviation Agency	690	690	686	745
National Aeronautics and Space Administration	965	965	1,110	1,236
Veterans' Administration	5,577	5,577	5,101	5,141
Other	756	780	755	832
General Services Administration	520	521	556	558
Housing and Home Finance Agency	1,119	1,819	948	1,368
Department of Agriculture	5,361	8,330	5,509	6,169
Department of Commerce	549	549	612	677
Department of Defense, military:				
Military functions	41,308	41,371	41,840	[1] 41,840
Military assistance	1,800	1,800	1,800	1,600
Department of Defense, civil	978	978	972	994
Department of Health, Education, and Welfare	3,909	3,940	4,026	5,505
Department of the Interior	837	838	888	940
Department of Justice	297	297	297	299
Department of Labor	525	1,566	264	289
Post Office Department	728	876	63	63
Department of State	268	268	351	363
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	992	993	1,126	1,156
District of Columbia	79	73	63	63
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	84,072

[1] Excludes program changes to be proposed in President's defense message.

NOTE.—Detail may not add to totals because of rounding.

(The following was later submitted for the record:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., March 28, 1961.

SUPPLEMENT TO STATEMENT OF DAVID E. BELL, DIRECTOR OF THE BUREAU OF THE BUDGET, MARCH 27, 1961

The President's message to the Congress on March 28 on national defense proposes certain expenditure increases. To take these increases into account and thereby present a full picture of the budget, it is necessary to revise the materials on the budget outlook presented to the Joint Economic Committee by the Director of the Bureau of the Budget on March 27. Specifically, there are attached hereto revisions of tables 1, 2, 4, 5, 6, 7, 16, and 17 which appeared in the March 27 presentation.

In summary, the budget impact of the President's defense recommendations is to increase estimated 1962 new obligational authority by $1,954 million and 1962 expenditures by $700 million over the totals originally contained in the Director's statement.

TABLE 1R.—*Estimated budget totals, fiscal 1961*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$79,024	$78,945	+$79
Administrative actions and recommended program changes		1,347	−1,347
Total	79,024	80,292	−1,268
Necessary revisions in estimate for January budget program (not related to new proposals)	−500	401	−901
Revised estimate, budget totals	78,524	80,693	−2,169

TABLE 2R.—*Estimated budget totals, fiscal 1962*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$82,333	$80,865	+$1,468
Recommended program changes, except defense, and added revenue from increased economic activity generated by new proposals	[1] 900	2,322	−1,422
Total	83,233	83,187	+46
Necessary revisions in estimate for January budget program (not related to new proposals)	−1,800	+417	−2,217
Revised estimate, budget totals, except 1962 defense proposals	81,433	83,604	−2,171
Recommended program changes in Department of Defense, military functions		+655	−655
Current estimate, budget totals	81,433	84,259	−2,826

[1] Includes revenues estimated to be generated by all program changes recommended by the administration.

NOTE.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300 million.

TABLE 4R.—*Estimated receipts from and payments to the public*

[Fiscal years; in millions]

Description	1961		1962	
	January estimate	Current estimate	January estimate	Current estimate
Receipts from the public:				
Budget receipts	$79,024	$78,524	$82,333	$81,433
Trust fund receipts	24,239	24,826	25,189	25,669
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Seigniorage on silver	63	63	82	82
Total	99,005	98,504	103,145	102,301
Payments to the public:				
Budget expenditures	78,945	80,693	80,865	84,259
Trust fund expenditures	24,102	24,548	25,155	26,683
Government-sponsored enterprise expenditures (net)	−196	−196	421	421
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Excess of interest accruals over payments, etc	725	725	314	314
Total	97,931	99,537	101,832	106,330
Excess of receipts over payments (+) or payments over receipts (−)	+1,074	−1,033	+1,313	−4,029

NOTE.—Detail may not add to totals because of rounding.

TABLE 5R.—*Budget expenditures by function*

[Fiscal years; in millions]

Function	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Major national security	$45,930	$46,720	$47,392	$48,172
International affairs and finance	2,310	2,435	2,712	2,826
Commerce, housing, and space technology	3,784	3,950	3,371	3,814
Agriculture and agricultural resources	4,936	4,905	5,101	5,743
Natural resources	1,951	2,045	2,138	2,162
Labor and welfare	4,483	5,089	4,759	6,020
Veterans services and benefits	5,227	5,239	5,296	5,301
Interest	8,993	8,993	8,593	8,693
General government	1,982	1,968	2,071	2,095
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,926
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	84,259

NOTES.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300,000,000.

Detail may not add to totals because of rounding.

TABLE 6R.—*New obligational authority by function*

[Fiscal years; in millions]

Function	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Major national security	$45,912	$45,975	$46,278	$48,062
International affairs and finance	3,207	3,563	3,102	3,210
Commerce, housing, and space technology	4,612	5,460	3,993	4,900
Agriculture and agricultural resources	4,696	7,238	4,605	5,285
Natural resources	2,049	2,050	2,012	2,109
Labor and welfare	4,937	6,171	5,025	6,442
Veterans services and benefits	5,438	5,438	4,963	5,003
Interest	8,993	8,993	8,593	8,693
General government	2,073	2,102	2,096	2,120
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	86,026

NOTE.—Detail may not add to totals because of rounding.

TABLE 7R.—*Major national security*

[Fiscal years; in millions]

Description	Expenditures 1961 estimate	Expenditures 1962 estimate	New obligational authority 1961 estimate	New obligational authority 1962 estimate
January 16, 1961, budget program	$45,930	$47,392	$45,912	$46,278
Reestimates of budget program:				
Department of Defense—Military:				
Military functions	761	235	63	
Military assistance	−200	−100		
Stockpiling and defense production	−10			
Revised estimate, January budget program	46,481	47,527	45,975	46,278
Proprosed program changes:				
Department of Defense—Military:				
Military functions	239	655		1,954
Military assistance				−200
Atomic Energy Commission (new obligational authority is for linear electron accelerator)		−10		30
Current estimate	46,720	48,172	45,975	48,062

TABLE 16R.—*Budget expenditures by major agency*

[Fiscal years; in millions]

Agency	1961		1962	
	January estimate	Current revision	January estimate	Current revision
Legislative branch and the judiciary	$208	$200	$203	$207
Executive Office of the President	61	72	92	92
Funds appropriated to the President:				
Mutual security, economic and contingencies	1,675	1,725	1,875	1,875
Other	43	58	75	175
Independent offices:				
Atomic Energy Commission	2,660	2,660	2,680	2,670
Export-Import Bank	−100	−50	−4	−4
Federal Aviation Agency	640	630	730	743
National Aeronautics and Space Administration	770	720	965	1,050
Veterans' Administration	5,314	5,400	5,369	5,404
Other	770	759	676	704
General Services Administration	442	420	496	498
Housing and Home Finance Agency	544	525	728	942
Department of Agriculture	5,739	5,807	5,782	6,440
Department of Commerce	511	511	566	614
Department of Defense:				
Military:				
Military functions	41,500	42,500	42,910	43,800
Military assistance	1,700	1,500	1,750	1,650
Civil	986	1,015	984	1,021
Department of Health, Education, and Welfare	3,716	3,744	4,005	4,798
Department of the Interior	785	785	873	906
Department of Justice	285	285	294	296
Department of Labor	295	892	223	654
Post Office Department	786	926	63	63
Department of State	260	260	345	351
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	965	965	1,095	1,120
District of Columbia	48	42	66	66
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,926
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	84,259

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Agency	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Legislative branch and the judiciary	$176	$176	$180	$184
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Funds appropriated to the President:				
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Other	507	607	13	13
Independent offices:				
Atomic Energy Commission	2,781	2,781	2,598	2,628
Federal Aviation Agency	690	690	686	745
National Aeronautics and Space Administration	965	965	1,110	1,236
Veterans' Administration	5,577	5,577	5,101	5,141
Other	756	780	755	832
General Services Administration	520	521	556	558
Housing and Home Finance Agency	1,119	1,819	948	1,368
Department of Agriculture	5,361	8,330	5,509	6,169
Department of Commerce	549	549	612	677
Department of Defense:				
Military:				
Military functions	41,308	41,371	41,840	43,794
Military assistance	1,800	1,800	1,800	1,600
Civil	978	978	972	994
Department of Health, Education, and Welfare	3,909	3,940	4,026	5,505
Department of the Interior	837	838	888	940
Department of Justice	297	297	297	299
Department of Labor	525	1,566	264	289
Post Office Department	728	876	63	63
Department of State	268	268	351	363
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	992	993	1,126	1,156
District of Columbia	79	73	63	63
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	86,026

NOTE.—Detail may not add to totals because of rounding.

Mr. BELL. I thought I might skim through it and not read it all.

It is a pleasure for me to appear before you to discuss the current budget outlook as presented in the President's message last Friday.

The figures that are reflected in this statement and in the President's message are those which have resulted from the administrative actions and recommendations to the Congress which the President has made in the last 2 months.

The review is complete, as you know, except for the Defense program. I have no figures today on the changes which will occur in the Defense budget. The President's message on that subject is expected to be sent to the Congress later this week.

So far as the current budget outlook is concerned in fiscal 1961, there was originally, in January 1960, an estimate based on the assumption of a continued and vigorous economic expansion that there would be a surplus of $4.2 billion.

Last October when there were signs of recession already evident, the surplus was estimated to be a little over $1 billion. In January 1961, President Eisenhower's last budget message suggested that there would be a very small surplus of about $79 million. This estimated surplus depended upon a number of assumptions with respect to both revenues and expenditures that now seem to have been in error.

Expenditures for the Department of Defense were clearly underestimated. Excluding the effects of any program changes made by the present administration, defense expenditures in fiscal 1961 are now estimated to exceed last January's estimate by $544 million.

The January budget also assumed that the Congress would enact postal rate increases effective April 1, in time to decrease budget expenditures for the postal service by $160 million this year. It is now clear that any increases in postal rates are unlikely to take effect before July 1.

There were a number of other estimates in the January budget which now seem to have been underestimated, and in some cases overestimated. The net upward revision which it is necessary to make in the 1961 expenditure estimate, therefore, for the January budget program itself, amounts to about $384 million.

Revenue prospects are still not too clear because so much depends on the tax collections in this month and next month. However, the best judgment of the Treasury Department is that budget receipts in this year will fall short of the January budget estimate by perhaps as much as $500 million.

Thus, excluding the effects of any proposed programs or budget amendments by the present administration, we would have a 1961 deficit of about $800 million.

Certain of the recommendations that the President made to the Congress, and the administrative actions that he has directed, will add to expenditures in fiscal 1961. These increases are estimated in total at about $1.4 billion. This amount includes over $550 million for the unemployment benefits bill which the Congress passed the other day, over a quarter of a billion dollars for military functions of the Department of Defense, and a number of additional sums, mostly in the agriculture field.

Therefore, considering the changes which Mr. Kennedy has brought about, or has recommended to the Congress, the current prospect for fiscal 1961 is for budget expenditures of $80.7 billion, receipts of $78.5 and a deficit of a little over $2 billion.

Looking at the 1962 budget, as it was presented in January, the expenditures were estimated at just under $81 billion, revenues at a little over $82, and a budget surplus of about a billion and a half. The estimate of revenues assumed a prompt and brisk upturn in economic activity as well as the enactment of various legislative proposals to increase revenues.

Senator BUSH. Mr. Chairman, before we leave the 1961 budget, may I ask a question?

The CHAIRMAN. Certainly.

Senator BUSH. Your estimates for the 1961 year, now indicating a deficit of $2.2 billion, do not include any changes in the defense budget as of today?

Mr. BELL. Yes, sir. They do include those changes which are expected to be reflected in budget expenditures as a result of the actions which the President has already announced.

You recall in his state of the Union message he announced the speedup of the purchase of five Polaris submarines and also additional planes to be bought for airlift purposes.

Furthermore, the Defense Department with the President's approval has altered the practice that has been followed for the last 3 or 4 years of holding back 20 percent on the payments of certain procurement contracts until the completion of the contract period.

Normally, under Government procurement contracts, as you know, payments are made as work is completed. The Defense Department had instituted a practice of holding back 20 percent until the end of the contract. This was a practice which certain committees of the Congress had not felt was suitable, and the GAO had raised some question about it, and it has now been changed.

As a result, during the next 2 or 3 months there will be paid out some $175 million which would otherwise have been held back until the completion of certain contracts which are underway.

That is the largest element of this $256 million which is referred to in my statement.

Senator BUSH. And all these things together make up that $256 million?

Mr. BELL. Yes, sir.

Senator BUSH. And there is nothing else?

Mr. BELL. And there is nothing else.

Moreover, the changes which the President will be sending up later this week are not expected to have any significant effect on expenditures in fiscal year 1961, although they will in fiscal 1962.

Senator BUSH. Thank you.

The CHAIRMAN. You may proceed, sir.

Mr. BELL. Thank you.

The President's message of last Friday indicated that his proposals for the fiscal year 1962, exclusive of Defense, are expected to increase expenditures by about $2.3 billion. The major elements of these incerases include about half a billion dollars for aid to elementary and secondary education, plus certain much smaller additional amounts for higher education and medical education. About $478 million for the Department of Agriculture, including price support operations, the distribution of surplus foods abroad, domestic distribution of surplus foods, school lunch, and so on. About $440 million for the fiscal 1962 portion of the temporary unemployment compensation program. These payments, of course, while they will show up as a budget expenditure in 1962, will, in fact, be repaid later from the proceeds of the increased Federal unemployment tax which was voted in the same bill. There are several other items which the President has recommended to the Congress.

All of these add up to about $2.3 billion of anticipated expenditures in the next fiscal year. These anticipated increases in expenditures can be expected to generate an increase in economic activity and in income over the next year which will, in turn, yield an increase in tax revenues estimated in the President's message at $900 million. Thus, the $2.3 billion increase in 1962 expenditures proposed by the President is less than the original estimated surplus of one and a half billion plus revenue increases of $900 million from the accelerated economic recovery that the President's program could be expected to generate.

The new budgetary proposals for 1962 have, as stated in the President's state of the Union message, been kept within his limit intentionally. Of themselves, and apart from the additional defense needs, they would not unbalance the budget submitted to the Congress by the preceding administration.

However, it is now apparent that both the revenue and expenditure estimates in the January budget were in error. The January budget estimate of expenditures for farm price supports and other activities of the Commodity Credit Corporation were based on assumptions as to output, domestic consumption, and exports of farm commodities which now appear to be optimistic. On this count alone, nearly $250 million needs to be added to the earlier estimates. Interest on the public debt, considering only the program set forth in the January budget but allowing for the presently expected shortfall in revenues, is now estimated to rise by about $100 million over the January figure. Taking account of a number of other increases and decreases in expenditure estimates, the total net effect of reestimating the January program is to increase 1962 expenditures by a little under $400 million.

Federal revenues in fiscal 1962 will depend largely on the course of the economy during the present calendar year. The Treasury and the Council of Economic Advisers now tell us that the economic assumptions underlying the budget sent to the Congress in January would have been unrealistically optimistic if the Government program advanced in that budget had been adopted. In fact, if the budget expenditure program recommended in January had prevailed, a revenue estimate of $80.5 billion for fiscal 1962 would have been closer to the mark than the $82.3 billion that was then predicted.

Allowing for the improvement in economic activity that the present budget proposals would generate, budget receipts for fiscal 1962 are now estimated at $81.4 billion.

While corporation income taxes are not expected to fall significantly below the January estimate, individual income taxes and excise taxes are now expected to be substantially lower. The present estimate of $81.4 billion for budget receipts for 1962 assumes the extension of corporate income and excise tax rates and the adoption of the President's proposal to prevent the diversion of taxes from the general fund to the highway trust fund.

Senator BUSH. Is that 81.4 billion reflecting a revision of the income estimates that you speak of at the bottom of page 6?

Mr. BELL. Yes, sir; it does.

Senator BUSH. You believe those are now on a sound basis?

Mr. BELL. They are as sound, sir, as revenue estimates can be at any time.

Senator BUSH. I appreciate it is not an exact science.

Mr. BELL. That is right. We think these are realistic.

Senator BUSH. You feel confident those figures should stand up?

Mr. BELL. Yes, sir. I repeat, subject to human error, but they are realistically prepared. The Treasury, the Council of Economic Advisers and ourselves are agreed as to the underlying economic assumptions which are reflected in them. The Treasury's estimators are the professional revenue estimators who have had much experience on this job.

The totals that we now see for the fiscal year 1962 are indicated in table 2 in the testimony. They show an anticipated deficit of just over $2 billion as of today, not counting the additional expenditures which would come from the President's defense recommendations.

Turning to the trust fund programs, a number of the programs which have been recommended in the President's messages would be financed that way. This, of course, includes the proposed liberalization of the old age, survivors, and disability insurance program, and the inclusion under it of medical care for the aged. The President has also arranged for a speedup in the payment of veterans life insurance dividends. He has, further, recommended increased funds for the Federal aid highway program.

The effect of these various recommendations and, again, of certain necessary revisions in estimates as compared with the January budget are shown in table 3, which indicates that the expenditures from the trust fund in 1961 are expected to be over $400 million higher than they were estimated in January. The estimated expenditures from trust funds in 1962 are now estimated to be about a billion and a half higher than they were estimated in January. The receipts in each case are roughly a half billion dollars higher according to our present estimates than they were thought to be in January.

Putting the trust fund and the conventional budget figures together, and excluding intragovernmental receipts and payments we have the table, which is very familiar to this committee, of receipts from and payments to the public.

Table 4 shows the current estimates on this basis. A marked change from the January estimates to today's estimates is shown. In both 1961 and 1962, in January, a surplus of receipts over payments was anticipated. In both cases today, an excess of payments over receipts is estimated.

In 1962 the current estimate of payments over receipts is a little over $3 billion.

Senator BUSH. That is table No. 4?

Mr. BELL. Yes, sir.

Senator BUSH. That is a combination of the trust fund accounts plus the budget.

Mr. BELL. That is right, plus the conventional budget. This is the table which most economists regard as very significant because it reflects the flow of cash between the government and the private sector of the economy. This does not reflect, as you know, Senator, the so-called income and product account calculations which would be much smaller. This table 4 does include transfer payments which simply reflect the transfer of income from one part of the population to the other and do not affect the production of goods and services.

Senator BUSH. Just so I understand that, at the bottom of page 9 in table 3, you show expenditures from the trust fund of $26,683 million and receipts of $25,669 million. That is a little over a billion dollars of deficit.

Mr. BELL. Yes, sir.

Senator BUSH. It is added to the 2.2 billion that you get the 3.3 billion on table 4?

Mr. BELL. Yes, sir. There are, as you know, on table 4 a number of adjustments which are made in addition to adding the net trust fund outlays to the conventional budget deficit. The net effect of those smaller adjustments is relatively small and therefore the total in table 4 is almost precisely the total that you come to by the figures you just gave.

I though it might be useful for the committee if in this first appearance that I have had the good fortune to have before this committee I said a few words about the basic approach of the new administration to fiscal policy. I have therefore a few additional paragraphs along these lines.

First I would like to say something about the longrun trend in Federal receipts and expenditures. This is, of course, a steadily growing country with an expanding labor force, continuing better technology, and a steadily increasing capacity to produce.

In these circumstances, as the President said in his message of last Friday:

> Federal revenue and expenditures levels must be adequate to meet effectively and efficiently those essential needs of the Nation which require public support as well as, or in place of, private effort.

The United States has very large resources to meet its obligations of world leadership and at the same time to achieve major advances in well-being here at home. The question at any given time, within the total of the Nation's capacity, is one of judgment as to the relative importance of the various alternative public and private uses of resources.

At the present time the President has proposed that we should move ahead along certain lines—to improve the education, health, and welfare of the people, to conserve and develop our natural resources, to provide needed public facilities, to increase scientific research and promote technological progress, and to strengthen free world defenses.

It would be a serious error of public policy, as well as false economy, to reject these public programs on an arbitrary assumption that we cannot afford them. This Nation can afford higher expenditures, public or private, up to the limit of its capacity to produce—a limit it has not approached for several years.

The question is one of relative importance. Each expenditure must be evaluated, in the President's words—

> in terms of our national needs and priorities . . . and compared with the urgency of the other budgetary requirements.

The relevant criterion in determining the desirability of a proposed use of resources for a public purpose is its value to the country in comparison to the value of using the same resources for other purposes, public or private.

Meeting our national needs responsibly in the years ahead may well mean increased rather than reduced Federal spending, until and unless we can arrive at a satisfactory agreement for the reduction of world armaments. As a matter of fact, budget studies published by the preceding administration, to which the President referred in his budget message, indicate that under the policies of the preceding administration, and under existing laws and programs, annual Federal budget expenditures would be likely to increase by 15 or 20 billion dollars in the coming decade and annual trust fund outlays by another ten to fifteen billion dollars.

By far the largest proportion of Federal Government purchases of goods and services is for national security purposes. The future level of expenditures for national security will depend in large part on world events in relation to U.S. interests, commitments, and risks. If there is no worsening of international tensions, and if changes in military technology continue along the lines that seem quite possible, the increase in defense expenditures in the years ahead might be moderate, and the percentage of the gross national product needed for defense purposes might decline, as it has in the past few years. It is also quite possible, of course, that world tensions might increase or technological changes of a different type might come along which would require a larger share of the national product for defense purposes.

If it proves possible to meet national security needs with a declining share of the national product, the needs of the Nation for education, health, community development, scientific research, development of natural resources, and other programs might be met without an increase, and perhaps with a decrease, in the share of the Nation's growing output of goods and services used by the Federal Government.

On the other hand, Federal transfer payments, such as social security benefits, and grants to States will probably continue to grow and perhaps also rise as a proportion of the gross national product. These disbursements as well as direct purchases of goods and services will have to be taken into account in determining the Government's total revenue needs.

As stated in the President's economic message last February 2, the American economy was capable in calendar 1960 of an output of $535 billion, 6 percent above the $503 billion actually produced. Moreover, our economic potential now grows at the rate of at least 3½ percent per year. At this rate, the gross national product increase to more than $750 billion by 1970 in present prices.

At today's tax rates, this growth would yield an increase in budget revenues from about $78 billion in fiscal year 1960 to approximately $120 billion in fiscal year 1970. These are minimum estimates. With proper public and private policies, we should be able to achieve a significantly higher rate of growth in national output.

The question would be one of choice, of course, as to whether we would want to use that proportion of the national output for public purposes, or a smaller or a larger proportion. The President's economic and fiscal recommendations have been prepared with the objective in mind of contributing to a higher rate of growth in national output.

The expenditures proposed are an important part of a national effort to close the gap between our actual and our potential output and to achieve adequate economic growth. This is particularly true of capital expenditures of Government that are needed to reinforce private capital expenditures, and expenditures to improve the quality and productivity of our human resources. These expenditures are as essential to economic growth as are private investment outlays.

Turning to the question of fiscal policy in the short run, within the framework of appropriate long-run goals, fiscal policies should be adapted to the needs of the current economic situation at any time. "Federal expenditure and revenue programs," to use the President's words, "should contribute to economic growth and maximum employment within a setting of reasonable price stability."

Moreover, as the President noted, because of the limits which the current balance-of-payments deficit places on monetary policy, fiscal policy must assume a heavier burden of responsibility for economic stability and growth at the present time.

Certain Federal expenditures automatically exercise a contracyclical influence. Unemployment compensation benefits and old-age and survivors insurance payments, for example, tend automatically to rise in times of economic decline and to fall, or in the case of OASI benefits to rise less rapidly, in times of boom.

Most Federal expenditures, however, exhibit no such automatic contracyclical pattern and it is necessary to make judgments as to their magnitude and timing in relation to the current economic outlook. Federal programs differ greatly in the degree they can or should be altered in response to fluctuations in business activity. Defense expenditures, to take a major example, should be set at the level needed to provide adequately for the defense of this Nation. Their timing can sometimes be adjusted within limits for economic reasons but their magnitude should be determined by defense needs. The same is true of some of the other Federal expenditures such as those for enforcing legislation, assuring justice, and so on.

At the same time, there are activities of Government which may or may not be worth undertaking, depending on the extent to which the Nation's resources are being utilized. If private demands are high, and productive resources are being pushed to capacity operations with consequent upward price pressures, then Government should retrench. Less urgent projects should be deferred.

On the other hand, when private demands are slack and productive resources are idle, such deferred public projects should be undertaken and can help economic recovery while filling a specific public need. Moreover, public works projects, especially those with a fairly short completion time, can be accelerated in times of low employment and retarded in terms of high employment. Procurement of certain supplies and equipment can also be speeded up when private spending is declining, and it was for this purpose that the President directed a few weeks ago a speedup in construction and procurement already funded.

Federal expenditure programs can be increased or decreased for the purpose of offsetting business cycle movements only within limits. Public expenditure programs cannot be turned on and off like a faucet. The authorization and appropriation processes are inevitably time consuming. Engineering, planning, and procurement arrangements also take time. This problem of an inevitable timelag is perhaps less serious now, when there is persistent slack in our economy, than it would be in more favorable circumstances. Programs of intrinsic merit can be initiated now without fear that their impact will be felt too late, when it is not needed. But steps to speed up public expenditure programs must always be taken with great care, lest waste and inefficient result.

On the revenue side of the budget, tax collections respond fairly promptly and more than proportionately to fluctuations in the general level of employment and income even if there is no change in tax rates. Although this sensitivity to the business cycle is probably a reflection of other tax objectives rather than of conscious design, it is nevertheless very desirable. We have learned from long experience that an attempt exactly to match tax revenues to expenditures each year, regardless of the level of business activity, would be not only extremely difficult but would be positively harmful.

The sensitivity of Federal revenues and payments to overall economic conditions helps to give the economy a built-in stability, valuable in arresting recessions and checking inflationary booms. But built-in stabilizers can at best do only part of the job. The automatic response of the tax system restores only a fraction of the loss of income and demand in recession. Similarly, it can do no more than offset part of the increases in spending in inflationary periods.

The automatic stabilizers therefore leave plenty of room for discretionary policies of economic stabilization, both fiscal and monetary. A major surge in private spending such as that which occurred shortly after the outbreak of the Korean war calls for an increase in tax rates, and indeed Congress then acted promptly and wisely to provide such an increase. Conversely, a serious or prolonged decline in economic activity relative to the Nation's potential would call for a reduction in tax rates.

As the Chairman of the Council of Economic Advisers emphasized in his testimony before this committee a few weeks ago, we must be alert not to permit tax and expenditure policies to stabilize employment and production at levels far short of full capacity. As the capacity of the economy grows, potential revenues grow even faster. The tax and expenditure structure that yields a deficit in a given year could well yield a surplus several years later when, even though the rate of unemployment is the same, the output of the economy is larger. Tax and expenditure programs should be adjusted from time to time to assure that automatic surpluses do not develop under circumstances when they would be harmful.

When the economy is operating at its full potential and investment funds are in short supply, a surplus contributes to economic growth by permitting some retirement of public debt, thus releasing savings for needed investment in private plant and equipment. But a surplus while unemployment is high, resulting either from deliberate action or simply from the automatic response of the tax structure to growth in the Nation's productive potential, can in itself prevent the attainment of full employment. Under such circumstances a budget deficit is clearly essential to economic recovery.

Then I have a few remarks, which I don't think I need to read, on the budget and the balance of payments, making the point primarily that the President has instructed the Treasury and the Bureau of the Budget to work together in assessing the relationship between budget outlays and the international balance of payments, and we will be doing this over the next few months as we look ahead to the budget for fiscal year 1963.

Finally, I should like to say a word about efficiency and economy in Government spending. It is an essential element of fiscal policy that expenditures be made in the most efficient way possible. As the President said in his budget message * * * "we must not allow expenditures to rise of their own momentum, without regard to value received. * * *" "It is my determined purpose," the President said, "to be a prudent steward of the public funds—to obtain a dollar's worth of results for every dollar we spend."

The Federal budgeting process is not only one of deciding which program shall be supported and which denied. It is also a process of maximizing the results per dollar of funds spent. I regard this as a major and continuing responsibility of the Budget Bureau. We must lead a continuing Government-wide effort to increase efficiency and reduce waste.

The existence of such waste in recent years has, I know, been documented in studies carried out by congressional committees, including a subcommittee of this committee. I hope it will be possible for us to continue to benefit from the interest of these committees, and that we can work together to bring about greater efficiency and economy in operation of all Government activities.

There are certain legislative actions which might be taken this year to assist in this effort. There are two specific proposals which I would mention here.

First is the President's suggestion that the Congress, in enacting appropriations for each department and agency, provide authority so that the head of the agency can transfer within his agency a modest amount of the funds available for operating expenses, subject to control by the Bureau of the Budget through the regular apportionment process. This will give the Department head flexibility and authority to exercise discretion in assigning funds and personnel within his agency, and could contribute substantially to the efficiency of his operations.

Secondly, enactment of the reorganization bill already passed by the Senate giving the President authority to transmit reorganization plans to the Congress will also strengthen the President in seeking efficiency and economy.

At the same time, I think it is clear that the task of driving out waste and improving efficiency is primarily a task of intelligent and continuous good management, acting day after day and month after month to find opportunities for improvement and to put those improvements into effect. This is principally a matter of executive branch leadership. I know, and the President knows, that a tremendous amount can be done within the authority already given by the Congress. I can assure you that the President takes a keen personal interest in this matter, and that we intend to keep steady pressure on every agency and to follow up every lead that may promise better and cheaper results in the expenditure of public funds. The President, as some of you know, has arranged for the continuing services of a group of distinguished consultants, including Mr. Robert Lovett and Don Price of the Littauer School at Harvard, to achieve steady improvement in Government operations. We expect to continue to give this matter top priority.

The prepared statement includes a number of details which I am sure there is no reason to read, but which are available for the record, covering the specific expenditure estimates and new obligational authority estimates for the different functional breakdowns and agency breakdowns in the Federal budget.

Mr. Chairman, that concludes what I had proposed to say at the beginning of the session, and I and my colleagues are available for such questions as you may wish to ask.

Representative REUSS. Thank you, Mr. Bell for your very comprehensive statement.

I would like to ask you first about the nature of the assumptions with respect to gross national product, personal income, and corporate profits underlying the three estimates you have mentioned: President Eisenhower's January assumptions, President Kennedy's March assumptions, and the assumptions of a quick return to a level of maximum employment.

Mr. BELL. Yes, sir. The estimates which underlay the Eisenhower budget, or the assumptions, I should say, were that the fiscal year 1962 would be a period of rising production, employment, and income.

While a precise figure for GNP was not made public, it is my understanding that the assumption anticipated that the average GNP during the calendar year 1961 would be in the neighborhood of $514 billion. As I recall it, the public statement that was made was a little under $515 billion. Within that total, we have the estimates for personal incomes and corporate profits. The assumption for personal income was $415 billion and for corporate profits $46 billion.

Representative REUSS. The estimates were for calendar 1961?

Mr. BELL. Yes, sir. The GNP and the income estimates for calendar 1961 are those which pretty well control the budget receipts during the fiscal year 1962.

Representative REUSS. What about under situation No. 2?

Mr. BELL. The present outlook of the Kennedy administration is that the GNP for the current calendar year is likely to be somewhat lower than was thought to be the case, or assumed, in January.

The Secretary of the Treasury said the other night when we were responding to press questions at the briefing on the President's budget message that the revenue estimates which I have given you today rest on the assumption that GNP during the present calendar year might be a little under $510 billion. This is, of course, assuming that the year will see an upturn and growth in the economy, and that we will be a good deal better off and will have a good deal higher GNP in the fourth quarter of the calendar year than we had in the first quarter.

Representative REUSS. What about personal income and corporate profits?

Mr. BELL. The Treasury is a bit reluctant, or has been a bit reluctant, to commit themselves firmly on personal income and corporate profit figures because the rate of tax receipts during the last few weeks has been running a bit differently than they expected. So, while 3 or 4 weeks ago, when Secretary Dillon was before this committee, he would have said that the January estimates of corporate profits were a bit high and the personal income estimates did not look too bad, today they feel it is the other way around. The corporate profits figures are holding up fairly well in relation to the January estimates, but the personal income does not look as though it is going to be as high as was thought in January.

Therefore, I do not have a precise figure to put before you. It is in the process of alteration, and the Treasury has told us that the overall total that I have just given you for the present fiscal year still looks right. But the mix as between personal and corporate flow of income looks a bit different than they earlier had thought, and this will affect the fiscal year 1962 distribution as well.

Representative REUSS. Will you submit the estimates on personal income and corporate profits to the committee as soon as you have them?

Mr. BELL. Yes; I would be very glad to.

Representative REUSS. I take it that at present GNP is estimated at about $509 billion and corporate profits, around $46 billion, or a little less.

Mr. BELL. Yes.

Representative REUSS. Your present assumption of a fall in GNP implies a reduction in personal income to perhaps $410 billion?

Mr. BELL. Yes; something like that. We will give you a firmer statement for the record, sir.

(The following statement was later submitted:)

Of various published economic aggregates, the two most relevant totals for estimating budget revenues are personal income and corporate profits. The personal income and corporate profit levels for the calendar year 1961, underlying the receipt estimates for the fiscal year 1962, are assumed to be $414 billion and $45.5 billion, respectively. These estimates include the income effect of the increased expenditures under the revised budget.

Gross national product is not used directly in estimating revenues. However, a rough approximation of the level of GNP consistent with the above personal income and corporate profit assumptions would be in the range of $510 to $513 billion. This level also reflects the effect of increased expenditures under the present budget estimates.

Representative REUSS. What is the unemployment rate, given a GNP of $509 billion?

Mr. BELL. Before I answer that, Mr. Reuss, perhaps I can say a word about the third part of your first question.

As you recall, in the President's message of last Friday, he said that the budget would be more than balanced at the present tax rates and with the present expenditure programs were we closer to the economic potential that the country has at the present time. If we were, in fact, at a high employment level, or low unemployment level, then we would be in the neighborhood of $540 or $550 billion. But starting from where we were as of the end of last year, it would not be feasible to anticipate that we could get back to that level within a calendar year.

If, therefore, we had a more rapid economic revival than the administration's economists now anticipate, it is possible that we could reach during the year a higher average GNP than was even anticipated in the January budget. If we were lucky and everything broke right, if there was a larger private upturn in investment and spending, and so on, than we now anticipate, starting from where we are, it is hard to see how the GNP could jump so that it would average during the year more than $518 or $520 billion. That would be about the maximum that you could conceivably anticipate of real growth in GNP during the present year.

Representative REUSS. Do you have related personal income and corporate profit assumptions for GNP of $518 to $520 billion?

Mr. BELL. I don't have them but we can provide them.

Representative REUSS. Would you do that, together with the probable unemployment figure?

Mr. BELL. Yes; I think that is a very good way to do it. I will submit a statement on that.

(The information requested is as follows:)

Personal income, corporate profits, and unemployment which would be associated with a GNP of $518 to $520 billion in calendar 1961 are estimated as follows:

Personal income, about $418 billion.
Corporate profits, about $47 billion.
Unemployment rate, about 6 percent.

To achieve these levels of income and profits from the much lower performance estimated for the beginning of the calendar year, the economy would have to accelerate rapidly, and reach levels far above the indicated yearly averages by the end of the year. Similarly, to average 6 percent for the calendar year, unemployment would have to decline during the year from the current high rate to below 6 percent by the end of the year.

Representative REUSS. Senator Bush.

Senator BUSH. You estimated the national income at $415 billion?

Mr. BELL. Personal income, yes, sir. That was the estimate that underlay the January budget.

Senator BUSH. Did you make a similar estimate on the gross national product in connection with these budget estimates?

Mr. BELL. The budget estimates in January, sir, rested on the assumption of an average GNP during this year of about $514 billion.

Senator BUSH. That would be a new high level, would it not?

Mr. BELL. For the year, yes, sir.

Senator BUSH. For any year?

Mr. BELL. Yes, sir. I mean on an annual basis, that is right.

Senator BUSH. You speak about the balance-of-payments problem and that it is not easy to assess the impact of Federal expenditures on the U.S. balance of payments. I agree with that. It is very difficult to assess that. But the thought that is in my mind is whether or not the impact of Federal expenditures, and especially of a budget deficit, does not have some effect upon the balance-of-payments problem. I mean not physically but psychologically. The psychological effect in turn creates a physical effect. In other words, the thought that is in my mind is this: If we are headed for a year in 1962 with a new high in gross national product and a new high in national income, but in view of those high figures, we still project a budget deficit which overall appears to be in the neighborhood of 3.5 billion, I just wonder what the effect would be upon our balance-of-payments problem through the psychological route, so to speak. We understand, and I believe it is true, that inflationary forces in this country, and budget deficits are usually inflationary, if not always, do have a very definite effect on confidence. The confidence of the people who own so much of dollars in this country from overseas is of vital importance in the whole picture.

Therefore, I ask you do you not think it is a bit hazardous, in view of the high level of production and expected income to still project a deficit of 3.3 billion?

Mr. Bell. I think the point, sir, of the importance of confidence is a very strong point and one which the present administration keeps very much in mind. I heard Secretary Dillon discuss this very point in very telling terms. His assumption is that people in Europe who have these balances in the United States, which they could withdraw, will be watching to see whether the present administration conducts its affairs with a sense of fiscal integrity and of sound fiscal policy.

Secretary Dillon says, and he has talked to more European bankers than I have, that they would be very disturbed if, during a year which started with a considerable recession, this administration attempted to reduce expenditures and lift revenues in order to achieve an exactly balanced budget or even a surplus. They would regard this as unsound fiscal policy.

They would say that the present economic situation calls for a stimulating effect in terms of fiscal policy. This is what they expect to see. This is what they are seeing—a modest deficit which can be expected to contribute to a rise in production, employment, and income, and not to a rise in prices.

This is a deficit which is quite small in terms of the overall budget and in terms of the overall GNP, and which therefore is not expected to result in any significant inflationary impact—because we have at the present time unemployed resources which can be put to work and therefore which would not result in pushing up prices.

This is not a matter on which I can give you a personal judgment because, as I say, I have not been in touch with the people in Europe whose confidence we seek. I can quote Secretary Dillon precisely as I have done. Perhaps when he was here he said something like this. I don't know whether the question was before the committee at that time. We are very much aware of the necessity for maintaining the confidence of the leading financiers and bankers in Europe, and I believe the President's actions thus far—his balance-of-payments message and the action he has taken to strengthen the dollar—have had a generally very reassuring effect as evidenced by the stoppage altogether for a while of the gold outflow and generally a much solider, more confident attitude in the financial community.

Senator BUSH. Do I understand that this $3.3 billion, which is the net overall, including the trust fund——

Mr. BELL. That is the cash deficit.

Senator BUSH. That is the dollar deficit?

Mr. BELL. That is right.

Senator BUSH. Does that include the revisions of the military budget that is coming down today or not?

Mr. BELL. No, sir; it does not.

Senator BUSH. Can you give the committee any idea as to how material a change that would make in the picture?

Mr. BELL. I regret, sir, that I cannot. The figure will be available within a very few days.

Senator BUSH. It is not available today?

Mr. BELL. No, sir. If the committee would like I would be glad to submit a statement later in the week summarizing the total picture as of that time. Would that be useful?

Senator BUSH. I would move that, Mr. Chairman.

Representative REUSS. Yes, it would be very useful and without objection the request is made.

(The data to be submitted follow:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C. March 28, 1961.

SUPPLEMENT TO STATEMENT OF DAVID E. BELL, DIRECTOR OF THE BUREAU OF THE BUDGET, MARCH 27, 1961

The President's message to the Congress on March 28 on national defense proposes certain expenditure increases. To take these increases into account and thereby present a full picture of the budget, it is necessary to revise the materials on the budget outlook presented to the Joint Economic Committee by the Director of the Bureau of the Budget on March 27. Specifically, there are attached hereto revisions of tables 1, 2, 4, 5, 6, 7, 16, and 17 which appeared in the March 27 presentation.

In summary, the budget impact of the President's defense recommendations is to increase estimated 1962 new obligational authority by $1,954 million and 1962 expenditures by $700 million over the totals originally contained in the Director's statement.

TABLE 1R.—*Estimated budget totals, fiscal 1961*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$79,024	$78,945	+$79
Administrative actions and recommended program changes		1,347	−1,347
Total	79,024	80,292	−1,268
Necessary revisions in estimate for January budget program (not related to new proposals)	−500	401	−901
Revised estimate, budget totals	78,524	80,693	−2,169

TABLE 2R.—*Estimated budget totals, fiscal 1962*

[In millions]

	Receipts	Expenditures	Surplus (+) or deficit (−)
Jan. 16, 1961, budget totals	$82,333	$80,865	+$1,468
Recommended program changes, except Defense, and added revenue from increased economic activity generated by new proposals	[1] 900	2,322	−1,422
Total	83,233	83,187	+46
Necessary revisions in estimate for January budget program (not related to new proposals)	−1,800	+417	−2,217
Revised estimate, budget totals, except 1962 Defense proposals	81,433	83,604	−2,171
Recommended program changes in Department of Defense, military functions		+655	−655
Current estimate, budget totals	81,433	84,259	−2,826

[1] Includes revenues estimated to be generated by all program changes recommended by the administration.

NOTE.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300,000,000.

TABLE 4R.—*Estimated receipts from and payments to the public*

[Fiscal years; in millions]

Description	1961 January estimate	1961 Current estimate	1962 January estimate	1962 Current estimate
Receipts from the public:				
Budget receipts	$79,024	$78,524	$82,333	$81,433
Trust fund receipts	24,239	24,826	25,189	25,669
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Seigniorage on silver	62	63	82	82
Total	99,005	98,504	103,145	102,301
Payments to the public:				
Budget expenditures	78,945	80,693	80,865	84,259
Trust fund expenditures	24,102	24,548	25,155	26,683
Government-sponsored enterprise expenditures (net)	−196	−196	421	421
Deduct:				
Intragovernmental transactions	4,195	4,783	4,294	4,719
Excess of interest accruals over payments, etc	725	725	314	314
Total	97,931	99,537	101,832	106,330
Excess of receipts over payments (+) or payments over receipts (−)	+1,074	−1,033	+1,313	−4,029

NOTE—Detail may not add to totals because of rounding.

TABLE 5R.—*Budget expenditures by function*

[Fiscal years; in millions]

Function	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Major national security	$45,930	$46,720	$47,392	$48,172
International affairs and finance	2,310	2,435	2,712	2,826
Commerce, housing, and space technology	3,784	3,950	3,371	3,814
Agriculture and agricultural resources	4,936	4,905	5,101	5,743
Natural resources	1,951	2,045	2,138	2,162
Labor and welfare	4,483	5,089	4,759	6,020
Veterans' services and benefits	5,227	5,239	5,296	5,301
Interest	8,993	8,993	8,593	8,693
General Government	1,982	1,968	2,071	2,095
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,926
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	84,259

NOTES.—If the Congress adopts the President's proposal for a revolving fund for foreign aid loans, total loan disbursements will not change but the recorded totals of budget receipts and expenditures in 1962 would each be reduced by about $300,000,000.

Detail may not add to totals because of rounding.

TABLE 6R.—*New obligational authority by function*

[Fiscal years; in millions]

Function	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Major national security	$45,912	$45,975	$46,278	$48,062
International affairs and finance	3,207	3,563	3,102	3,210
Commerce, housing, and space technology	4,612	5,460	3,993	4,900
Agriculture and agricultural resources	4,696	7,238	4,605	5,285
Natural resources	2,049	2,050	2,012	2,109
Labor and welfare	4,937	6,171	5,025	6,442
Veterans' services and benefits	5,438	5,438	4,963	5,003
Interest	8,993	8,993	8,593	8,693
General Government	2,073	2,102	2,096	2,120
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	86,026

NOTE.—Detail may not add to totals because of rounding.

TABLE 7R.—*Major national security*

[Fiscal years; in millions]

Description	Expenditures		New obligational authority	
	1961 estimate	1962 estimate	1961 estimate	1962 estimate
Jan. 16, 1961, budget program	$45,930	$47,392	$45,912	$46,278
Reestimates of budget program:				
Department of Defense (military):				
Military functions	761	235	63	
Military assistance	−200	−100		
Stockpiling and defense production	−10			
Revised estimate, January budget program	46,481	47,527	45,975	46,278
Proposed program changes:				
Department of Defense (military):				
Military functions	239	655		1,954
Military assistance				−200
Atomic Energy Commission (new obligational authority is for linear electron accelerator)		−10		30
Current estimate	46,720	48,172	45,975	48,062

TABLE 16R.—*Budget expenditures by major agency*

[Fiscal years; in millions]

Agency	1961		1962	
	January estimate	Current revision	January estimate	Current revision
Legislative branch and the judiciary	$208	$200	$203	$207
Executive Office of the President	61	72	92	92
Funds appropriated to the President:				
Mutual security—Economic and contingencies	1,675	1,725	1,875	1,875
Other	43	58	75	175
Independent offices:				
Atomic Energy Commission	2,660	2,660	2,680	2,670
Export-Import Bank	−100	−50	−4	−4
Federal Aviation Agency	640	630	730	743
National Aeronautics and Space Administration	770	720	965	1,050
Veterans' Administration	5,314	5,400	5,369	5,404
Other	770	759	676	704
General Services Administration	442	420	496	498
Housing and Home Finance Agency	544	525	728	942
Department of Agriculture	5,739	5,807	5,782	6,440
Department of Commerce	511	511	566	614
Department of Defense—Military:				
Military functions	41,500	42,500	42,910	43,800
Military assistance	1,700	1,500	1,750	1,650
Department of Defense—Civil	986	1,015	984	1,021
Department of Health, Education, and Welfare	3,716	3,744	4,005	4,798
Department of the Interior	785	785	873	906
Department of Justice	285	285	294	296
Department of Labor	295	892	223	654
Post Office Department	786	926	63	63
Department of State	260	260	345	351
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	965	965	1,095	1,120
District of Columbia	48	42	66	66
Allowance for contingencies	25	25	100	100
Subtotal	79,621	81,369	81,532	84,926
Deduct interfund transactions	676	676	667	667
Total	78,945	80,693	80,865	84,259

NOTE.—Detail may not add to totals because of rounding.

TABLE 17R.—*New obligational authority by major agency*

[Fiscal years; in millions]

Agency	1961 January estimate	1961 Current revision	1962 January estimate	1962 Current revision
Legislative branch and the judiciary	$176	$176	$180	$184
Executive Office of the President	72	72	116	116
Funds appropriated to the President:				
Mutual security—Economic and contingencies	2,131	2,131	2,200	2,400
Other	507	607	13	13
Independent offices:				
Atomic Energy Commission	2,781	2,781	2,598	2,628
Federal Aviation Agency	690	690	686	745
National Aeronautics and Space Administration	965	965	1,110	1,236
Veterans' Administration	5,577	5,577	5,101	5,141
Other	756	780	755	832
General Services Administration	520	521	556	558
Housing and Home Finance Agency	1,119	1,819	948	1,368
Department of Agriculture	5,361	8,330	5,509	6,169
Department of Commerce	549	549	612	677
Department of Defense—Military:				
Military functions	41,308	41,371	41,840	43,794
Military assistance	1,800	1,800	1,300	1,600
Department of Defense—Civil	978	978	972	994
Department of Health, Education, and Welfare	3,909	3,940	4,026	5,505
Department of the Interior	837	838	888	940
Department of Justice	297	297	297	299
Department of Labor	525	1,566	264	289
Post Office Department	728	876	63	63
Department of State	268	268	351	363
Treasury Department:				
Interest	8,993	8,993	8,593	8,693
Other	992	993	1,126	1,156
District of Columbia	79	73	63	63
Allowance for contingencies	150	150	200	200
Total	82,068	87,141	80,867	86,026

NOTE.—Detail may not add to totals because of rounding.

Senator BUSH. The trust fund figures a few years ago used to produce a cash surplus of about $2 billion. When I first came down here I think it was as high as $3 billion.

Mr. BELL. Yes, sir; it was.

Senator BUSH. Now we find it in the red to the extent of over a billion dollars. How do you project that in the years ahead, Mr. Bell? Is that something you have given attention to since you have been here?

Mr. BELL. No, sir; I have not been able as yet to look ahead at those figures. Perhaps one of my colleagues would be more familiar with them.

Senator BUSH. We would be glad to hear from him.

Mr. COHN. My name is Samuel M. Cohn, I am Chief of Fiscal Analysis in the Bureau of the Budget.

The present large outlays in the trust funds are accentuated by the fact that a great deal of them are for the unemployment trust fund. During a period of economic recession these are great and hence distort the long-run trend of trust fund outlays at full employment.

Abstracting from changes in the unemployment trust fund, the largest trust fund is for old-age, survivors, and disability insurance. Broadly speaking, the outlays of this trust fund are less than the revenues that come into the trust fund in the first few years after tax increases—employment tax increases—which are already in existing law. Toward the end of the period, just before another tax-rate increase, the expenditures of the trust fund approach rather closely the receipts of the trust fund and for 1 year or so may exceed those receipts. But over the next 5 to 10 years there is still going to be some excess of receipts coming into the old-age and survivors insurance trust fund.

Senator BUSH. Mr. Bell, these estimates that you have given us for the gross national product and income, are these figures based on the assumption that we already are in recovery from the recession in which we have found ourselves?

Mr. BELL. They are based on the assumption, sir, that we are just about at the turning point. During the next quarter, at some stage, we will start moving upward again, so that by the summer and through the fall we will be moving upward at a fairly clear cut and strong rate.

Senator BUSH. To what do you attribute the fact that we are coming out of this? What are the factors that lead you to believe that we will be moving ahead in the next quarter from the bottom of this recession?

Mr. BELL. I am not sure I can give you as good an answer to that, Senator, as Mr. Heller, or others on the Council of Economic Advisers. It appears that the increases which were taking place for quite a while in unemployment have not taken place for the last 2 or 3 weeks, so that the volume of unemployment seems to have hit its peak, and we can hope that it will not start to increase again.

The other indicators of production and income which are available, although most of them as you know are 2 or 3 or 4 weeks back by the time we have the figures, seem consistent with the possibility that the fall in production and income has come to its end, and that as of perhaps the next quarter we may look for some rise in production and income.

The actions which President Kennedy has taken in a number of respects have already begun to be effective, although none of us would claim that there has been a very major effect as yet from any of the President's proposals, except in the sense that he has clearly demonstrated the determination to do what is necessary to make sure that the economy turns around and starts upward. This in itself should produce confidence and the expectation of recovery, and therefore encourage people to make investments and to hire people, and so on.

During the next 2 or 3 months there will be a substantial effect from some of the proposals that President Kennedy has made.

Senator BUSH. As for instance?

Mr. BELL. As for instance the temporary unemployment compensation payments which will be starting out now within about 2 weeks, I believe, and during the next 3 months will add about half a billion dollars to the purchasing power of people who otherwise would be in very poor shape indeed.

The speedup in procurement and in construction within funds which were already appropriated is having some effect now and will have more in the next month or two. This was essentially moving forward purchases or construction which would have taken place a few months from now and trying to do it immediately insofar as there was that flexibility in the program concerned.

So that the basic situation clearly up to now has been determined by the factors that were going along when the new administration took office, but it is fair to say, I think, that there has been some impact from the attitude of the new administration and there is beginning to be some effect from its direct actions.

Mr. Chairman, my colleague, Mr. Turner, has one point he would like to add, if he might.

Mr. TURNER. My name is Robert Turner. I am Assistant Director of the Bureau of the Budget. We think there is good reason to believe that, to the extent that this has been an inventory cycle, a turn is not very far off. Inventory sales ratios were not excessively high last year. They were somewhat above normal, but they were not nearly as high as before the 1958 recession.

We have been going through a period of inventory liquidation lately. Just how soon the turn will come no one can be sure, of course, and it may not come for several months. But it should occur soon. When that happens we will then have inventory buying adding to the level of income and employment rather than subtracting as it is doing now.

A second point which is implied in Mr. Bell's statement is the fact that business investment has been holding up fairly well. Indeed the surveys of anticipations indicate that even though there will be some decline in the first half of the year, a small decline, there probably will be a rise in the second half of the year. This should contribute to a pickup in the fall.

Senator BUSH. May I ask one question about the inventory matter. I was under the impression that the inventory accumulation in the first 6 months of last year was very substantial. Perhaps that one factor more than any other lead to the declining business activity in the last half of the year. Don't you agree with that?

Mr. TURNER. Yes. In substantial measure this was a reaction from the high inventory buildup last year, which was partly a voluntary inventory accumulation and partly an involuntary inventory accumulation, in that sales did not expand as rapidly as people thought they were going to expand and consequently we found ourselves in the first half of the year with materials coming in the back door faster than they were going out the front door. Consequently, inventories built up.

Senator BUSH. Thank you.

Representative REUSS. Senator Pell.

Senator PELL. I was wondering if you had any idea what the unemployment level was that was assumed in your estimate.

Mr. BELL. The translation of GNP estimates into unemployment estimates, as you know, is not an easy calculation to make. Depending on your assumptions, you can come out with various figures. If the committee would like, we can put a more detailed statement in the record.

It is my understanding that the Council of Economic Advisers considers it likely that under the prospects for recovery which we have, we will still, by the end of the year, be facing a considerable degree of unemployment, perhaps still in the neighborhood of 6 percent or 6-plus percent, which is not a satisfactory situation.

They have emphasized in their testimony before this committee that the current problem is not simply a short-run recession problem but a recession superimposed on long-term slack, and even that superimposed on a rather unsatisfactory national rate of economic growth in recent years.

Consequently, while they anticipate—the President anticipates and we all do—that by the end of the year the economy will be moving upward again, none of us has a feeling that by that time we will have regained the full capacity operation of the economy which we should all be looking forward to, and that there will still be a question as to whether we have accomplished a lifting of the rate of economic growth in the country.

Therefore, in a sense it is easier to persuade one's self that we can see our way clear to an ending of the present recession than to persuade one's self that we have the answer to the problems of long-term slack and of the long-run growth rate. I think all of us, from the President on down, still feel that these are major problems and we are by no means confident that the program of the Government, and that the activities of private persons, corporations, businesses and so on, will be sufficient during the present year to meet those particular problems.

Senator PELL. But to be as specific as you can—for instance, in figuring out the Government trust funds where you have to assume a rate of unemployment—I was wondering what the basic figure was that was being assumed in the Bureau of the Budget for fiscal 1962.

Mr. BELL. We will have to submit that to you for the record, if we may, sir.

(The information requested is as follows:)

The fiscal year 1962 estimates for the unemployment trust fund assume an average rate of insured unemployment of 4.6 percent, which is consistent with an average rate of total unemployment of about 6 percent for the year. This implies a gradual decline in the rate of unemployment between the third quarter of calendar 1961 and the second quarter of calendar 1962. The rate of insured unemployment, rather than total unemployment, is used in making projections for the unemployment trust fund. These rates differ because not everyone in the labor force is insured and because some who are insured exhaust their benefit rights and are thereafter no longer counted as insured unemployed, even though counted among the total unemployed.

Senator PELL. There is one other development concerning that thought which is in your testimony where you have, to my mind, expressed the correct implicit assumption that our really important objective is to balance our labor supply to demand, to achieve as close as we can full employment and that this objective of achieving full employment should be subordinated to the question of balancing the budget. I was wondering if you could develop your thoughts, that unemployment is hightened by a budget surplus.

Mr. BELL. Actually, if the Government is running a surplus when there is high unemployment, this is taking funds away from businesses and from consumers, decreasing the purchasing power in the economy, and contributing to a further downturn rather than to a reversal of the assumed serious condition of unemployment.

In the fancy phrase that they use around this town, it is counterproductive. It does the wrong thing. Running a surplus in time of high unemployment is contributing to the difficulty rather than alleviating it.

Senator PELL. I would agree with you.

Finally, I was wondering whether you had given thought in your capacity as Director of the Budget to the idea of converting the budget year to a calendar year from a fiscal year.

Mr. BELL. No, I have not. I would be glad to do so.

There are a number of possible changes in the presentation of the budget and in the accounting system. There is the possibility, for example, of consolidating the conventional and cash budgets in some way. These are matters which I regard as important and to which I expect to devote some attention. I am sorry that up to now we have been busy revising the budget we inherited, which now fortunately is completed or will be completed with the defense message in a day or two. I will get then to matters of this kind.

Senator PELL. Thank you, sir.

Representative REUSS. Mr. Javits.

Senator JAVITS. First, let me welcome you to the committee. This is the first time I have had the opportunity to meet you.

Mr. BELL. Thank you, sir.

Senator JAVITS. I want to pursue for a minute Senator Pell's question about unemployment. I get the impression from the Chairman of the Council of Economic Advisers that inherent in your planning in this administration was the acceptance—I don't mean willing acceptance—of a 4 percent unemployment figure as being just about the best you could hope for under existing conditions.

Was that inherent in your calculations, too?

Mr. BELL. We do not anticipate, Senator, that we will be close to a 4-percent rate by the end of this calendar or fiscal year. We assume that this should be our interim target, to be reached as soon as we can. As I remember Mr. Heller's comments, the reason why he felt that 4 percent was about the optimum rate to seek under present conditions was that if you pursue policies which will reduce unemployment below that level, then the way our institutions work we would probably be necessarily suffering rather considerable inflationary pressures.

So that while 4 percent is higher than we would like to see, it looks as though it may be about as low as we can push the rate of unemployment without serious risk of inflation. However, as I indicated, the anticipation is that we are not necessarily going to be below 6 percent by the end of this calendar year. We will hope to be. My guess is that when we give Senator Pell his precise figure it will be somewhere around there rather than close to 4 percent.

Senator JAVITS. What about the assumptions for the fiscal year 1961–62. Are they the same as those you have just outlined for us in this calendar year 1961?

Mr. BELL. We would hope that the rate of unemployment would continue to fall during the first half of the calendar year 1962. As I say we are not operating on the assumption that we can get down to 4 percent by June 1962.

Senator JAVITS. Under these circumstances is the estimate with respect to temporary unemployment compensation, which we just passed, a fair one? In short, are we to expect that these figures which you have given us on temporary unemployment compensation are reliable not only for the 1961 period but for the fiscal year 1962 as well?

Mr. BELL. They are as reliable as anybody can make right now. They are consistent with what I have just been saying about the overall rate of unemployment.

Senator JAVITS. In view of your views, would you have liked to see any permanent provision made for this kind of unemployment rather than just a terminable provision as we did under the law we passed?

Mr. BELL. This is a matter on which my views are less significant than those of Secretary Goldberg and the President. If you want my personal views, I am inclined to think that it would be useful to have something like this permanently in the law.

Senator JAVITS. Considering the fact that unemployment now can be classed as if it were an endemic issue, until we begin to deal with fundamental questions of automation and expansion of markets abroad in a much bigger way.

Mr. BELL. Yes, sir.

Senator JAVITS. And even with hours of work.

Mr. BELL. That is right. It is also true, Senator Javits, as I am sure you recall, that the President made some reference in the economic message in early February, to his hope that there would be some improvements in our permanent unemployment compensation system quite apart from adding this temporary extension provision.

Therefore, to respond to your question accurately would call for some proposals to strengthen the permanent system as well as to have some kind of emergency arrangement which might be available whenever unemployment became unduly large.

Senator JAVITS. So that it is fair to say that there will in the future, perhaps even in the near future, again be before us a real issue of what we are to do about Federal standards or criteria for the States in terms of the unemployment compensation system.

Mr. BELL. Yes, sir. I cannot predict exactly when the President would make recommendations on this, nor in what form. But I know he assumes that it is necessary for us to keep working on the problem of improving the permanent system.

Senator JAVITS. I, too, was much interested by your explanation on page 15 as to the influence upon employment of budget surplus or deficit. I would like to ask you this question. Are we to assume, aside from the recommended increases in certain tax rates, like postal rates, that these figures are not premised on any contemplated tax decrease or tax increase?

Mr. BELL. That is correct, sir.

Senator JAVITS. It assumes a tax structure pretty much as at present?

Mr. BELL. Tax revenue totals; yes, sir.

Senator JAVITS. Is that dictated by the economic ideas of the administration, or is that dictated by its social ideas?

Mr. BELL. I am not sure I follow the question.

Senator JAVITS. What I mean is that we are all getting hard-headed about pay as you go. We are facing a deficit both in 1961 and 1962. This question is, Shall we think about doing something about that, or on the other hand, shall we be dominated by the idea that to get us out of this recession we are still in, we have to cut taxes?

Mr. BELL. The President's judgment up to this point is—and there are economists who differ with this—that the program he has thus far recommended, and which is reflected in the figures I have given here today, will be adequate to deal with the recession insofar as it can now be understood.

He has, however formally indicated that he will be taking a fresh look at the situation next month and I assume he will be looking at it periodically. If we do not find that the economy is responding as he now anticipates that it will, then I would assume he would consider very seriously the possibility of asking for temporary or permanent tax reduction.

Is this responsive to your question?

Senator JAVITS. Yes, it is, but there is certainly no contemplation of tax increase to put us on a pay-as-you-go basis in view of these deficits.

Mr. BELL. The basic position there, Senator, if we understand the economy correctly and the Federal Government's place in it, is that estimates of what would be the revenues from the existing tax structure at higher levels of economic activity indicate that the basic tax structure is sufficient to give us a balanced budget and a more than balanced budget if we were closer to full employment.

So for these reasons it does not seem to be necessary to recommend any basic increase in the tax revenue system. What we need is to get back to a higher level of economic activity, at which point we would have a balanced budget, and more than a balanced budget, as far as we can now see.

Senator JAVITS. I might say, Mr. Bell, that the answers you have just given are tremendously important to the business community. I know they are consistent with your policy. When you say it in this consolidated way from the high seat you occupy I think it is something that the American business community wants to hear put just that way.

Mr. BELL. Thank you, sir.

Senator JAVITS. I have two very minor questions. One is that I am a little puzzled by your statement where you speak of the Eisenhower budgetary estimates and you say on the other hand, the expenditures were overestimated in some cases, notably by $423 million for farm price supports and related activities.

Mr. BELL. Yes, sir.

Senator JAVITS. Then you skip down three paragraphs and you say:

> Certain of the recommendations that the President has made to the Congress and administrative actions that he has directed will add to expenditures in this fiscal year.

If you add up the farm price supports, it is $407 million.

Mr. BELL. Yes, sir, including all the agriculture programs listed there.

Senator JAVITS. What I would like to know is why the criticism if the amounts about balance out.

Mr. BELL. It was not meant to be a criticism, Senator. It was meant to be a factual statement. These estimates of the cost of farm price supports, as you know, are very difficult to make. One has to estimate what the crop is going to be, what the market conditions are going to be both at home and abroad, and how much the farmers are going to have on hand and how much of that they are going to want to put under loan under the various CCC systems.

The two figures to which you have called attention reflect this kind of distinction. If the price support levels which were assumed in the Eisenhower budget had stayed in effect, then the changes in the outlook for the volume of the crop, the market conditions and so on, would have resulted in this decrease in the anticipated cost of the price support activities. However, President Kennedy recommended new feed grain legislation for the 1961 crop, and directed his Secretary of Agriculture to make some changes in the price support levels and the activities under the price support system; and, consequently, this will have expenditure effects.

So that the changes President Kennedy made in cotton price supports, peanuts, rice, milk, and so on, were deliberate changes and there is a cost connected with them. These changes, together with the feed grain legislation, explain the $225 million in 1961, as well as some increase in 1962 expenditures.

Senator JAVITS. We noted in your budget message an item of Department of Defense civil functions, Corps of Engineers, construction $17 million, which was added to the 1961 budget.

Mr. BELL. Yes, sir.

Senator JAVITS. We had some information which leads me to ask this question because I think it should be stated for us all. What is the policy of the Budget Bureau about notifying anybody here on Capitol Hill in advance of the publication of a particular project of which a Member's area is going to be benefited, as to what the projects are and where they are located.

Mr. BELL. I am not sure I can answer that as fully as I should be able to, Senator. The White House staff, Mr. O'Brien, and his colleagues, by and large notify the offices of affected Members of Congress usually, I think, on the morning of the day on which a recommendation comes up to the Hill. Whether they make it a practice of notifying everyone affected, or whether they concentrate on the Democrats, I don't know.

Senator JAVITS. Can you find out for us what will be the policy? We might just as well know the ground rules. I just haven't got enough facts to say anything about it beyond that, but from what we have learned we certainly ought to know the ground rules.

Mr. BELL. I would be very glad to find out and put a statement in the record.

Senator JAVITS. Thank you very much.

(The information requested follows:)

The policy of the Bureau of the Budget has been to notify Members of Congress of the President's decision on individual projects, as soon as the President's recommendations have been transmitted to the Congress, whenever a Senator or Representative has previously requested that he be notified. In addition, the affected agencies have customarily issued a press release providing

information regarding individual projects, concurrently with release of the President's budget recommendations. It has not been the policy of the Bureau to notify those Senators and Representatives who have not expressed an interest in a particular project. The Bureau expects to continue the policy of notifying individual Senators and Representatives who have expressed an interest in being informed as soon as the official recommendations are transmitted to the Congress.

Representative REUSS. Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much. I first of all would like to say I enjoyed your presentation very much, Mr. Bell. I would like to ask you, Are there any studies or bases of experience on which you determine what the effect is upon the economy and the budget by pouring a half billion dollars into the economy as additional unemployment compensation, as compared to a half billion dollars worth of missiles purchased or a half billion dollars worth of tax reduction or fast tax writeoff on machine tools?

Mr. BELL. Economists have worried a lot about these questions. My own judgment is, and I will ask my colleagues to check me on this, that we do not yet have accurate enough and sensitive enough formulas or known relationships so that we can put into a machine these alternative possibilities and get out at the other end reliable estimates of the effects on investment of production or employment or whatever we wanted to know.

There are some generalizations which are often made. I think it may be said that the answer will differ at different stages of the business cycle. If, for example, we are at a high stage of business cycle, employment is quite full, and so on, then accelerated depreciation, encouraging higher rates of investment, would have one kind of an effect. If, on the other hand, we are at a relatively low stage of the business cycle, where current productive capacity is not being used, then the effects of that sort of thing would be different.

The case is similar with the other illustrations you have used, the purchase of missiles or the addition to purchasing power directly by increasing unemployment compensation benefits.

At the present stage, which is not a severe depression but a significant recession, I think one might conclude that all three of these things would be beneficial. Perhaps the largest single jolt from $500 million spent in these alternative ways might come from the temporary unemployment compensation benefit increase, because this puts money in the hands of people who badly need to spend it right away, and therefore will add directly and immediately to purchasing power with the attendant secondary and subsequent effect of raising output and income.

Representative GRIFFITHS. The view has been expressed that perhaps we are 10 years behind in our machine tools and that we would need to replace them with new ones, with the suggestion that the purchasers be given a fast tax writeoff and that this would spur the economy. I would like to ask you, Is it not also possible that while this may give a temporary increase in employment it would in the long run decrease employment?

Mr. BELL. Let me say first, Mrs. Griffiths, that my own feeling would be at the present time—I think I am expressing the administration's point of view, also—we need both some increase in direct outlays for things like unemployment compensation benefits and attention to the underlying rate of investment and stimulation of increased modernization of equipment.

As to whether the increased modernization will over a period of time give a net increase or decrease in employment, again you are in the middle of a subject, as I am sure you know, that economists debate all the time and study all the time.

We have historically seen very rapid rates of growth in investment in machinery and in the capitalization in the economy per worker, without any substantial longrun decline in employment. This has been typically the way the U.S. economy has grown. We have had a great increase in the machinery per worker and yet the attendant effects have not been such as to result in longrun unemployment.

There are those who argue that the present wave of automation is different and should be taken more seriously. Obviously, it should be taken seriously and we should study these matters very carefully. I don't know myself of any firm reason to be afraid in the long run of modernization in the future any more than we should have been afraid of it in the past. We have to consider in the specific cases where modernization takes place what happens to the workers who are displaced. We need programs, and some of them we don't have, for retraining, for guidance, for assisting people to find new employment when they are displaced from the employment that they have had before.

We obviously have to be concerned, also, with the total volume of investment and saving, production, and income in the country. You could easily conceive of a situation in which you could have substantial modernization in two or three sectors of the economy, but the overall economy would be slack and get slacker. This would be a very bad position in which to persuade one's self that overall employment was going to stay up. So you would have to have a combination of specific programs, public and private, directed to assisting people who are directly affected by modernization to find other jobs, and an overall total set of national policies which continue to encourage, stimulate, and produce relatively full employment—then, presumably, we have a situation in which we need not be overly concerned about the steady improvement in technology.

Representative GRIFFITHS. Do you have at the present time any suggestions for changing the budget, that is, the character of the document, so that it would be more easily usable by Congress in their economic decisions and more easily understood by both the Congress and the public?

Mr. BELL. Again, I must apologize, Mrs. Griffiths. I know considerable changes have been made in recent years in the presentation of the budget. One change was made incidentally, about 10 years ago when I was in the Budget Bureau, and that was to produce a small "budget in brief" which I think was a very good innovation. There may very well be many other things that we should do.

I expect to put this high on our agenda but up to now I am sorry I do not have a good answer for you on this question.

Representative GRIFFITHS. Thank you very much.

Thank you, Mr. Chairman.

Representative REUSS. Mr. Bell, I refer to your remarks, entitled, "The Budget and the Balance of Payments."

Mr. BELL. Yes, sir.

Representative REUSS. Am I right in my recollection that the President has imposed upon you and upon the Secretary of the Treasury the joint and several responsibilities of evaluating the balance of payments effects of any proposed budget? Exactly what was the instruction? Was it in a letter, in an Executive order, or in the balance of payments message?

Mr. BELL. It was in the balance of payments message. The statement of what he had instructed us to do was in essence to consider in the future in making budget decisions the impact which those decisions would have on the balance of payments.

Previously, I think it is fair to say the decisions on whether to support a given Federal program through the budget at one rate or another, the decision to spend this much or that much, were made without regard to where the money was to be spent. What the President said in essence was that in the future we should get separately the figures which indicate how much of the proposed spending is to be undertaken abroad, under what circumstances, the effects of the proposed foreign spending, and that we should consider these elements when decisions on budget policy are made.

As I indicated in this statement one cannot reach the simple conclusion that because an expenditure is proposed to be made abroad it is less desirable than if it were made at home. It may indeed be a most urgent expenditure with great importance to the Nation. So that the simple fact that it is to be made abroad does not by itself give you grounds for reaching any conclusions about it.

Clearly, it is necessary to consider the total effects of Federal spending in relation to the balance of payments problem which we have. The Secretary of the Treasury and I are now formally instructed to do that and our staffs are working together to prepare a systematic procedure which will be applied as we consider the various budget requests in connection with the 1963 budget.

Representative REUSS. I think you have answered my question. I didn't want to seem ungracious about your statement on pages 15 and 16, but it didn't seem to me to be the analysis of the budget impact on our balance of payments, requested by the President. I can understand your inability to produce it as of March 27.

Mr. BELL. That is right.

Representative REUSS. Am I right in thinking that with the presentation of the fiscal 1963 budget in January 1962 there will be a comprehensive analysis of the impact of the budget on our balance of payments?

Mr. BELL. In the preparation of that budget there will have been a comprehensive attempt to understand each proposed budget expenditure in relation to the balance of payments. We have not yet reached any conclusion—we have not thought about how we should present this. As you know the budget now is accompanied by a number of special analyses. It may be that we should add a new special analysis which would be published each year or it may be that the matter can be handled in some more simple way. Furthermore, I am not sure we should wait until next January. It may be that we can from time to time as we get along with this work say some useful things and present some useful data.

Representative REUSS. I am glad to hear that. I know the members of the Joint Economic Committee would welcome whatever insight you can give us on the balance of payments impact of the 1962 budget. Would you agree with me, Mr. Bell, that there is nothing more intrinsically difficult about making balance of payments projections than in making domestic projections?

In the latter you have to make educated guesses on components of gross national product—personal income, corporate profits, etc. In the second exercise you would have to make guesses as to imports, exports, capital movements, foreign travel and similar questions. But your intention is to buckle down and try to do those, is it not? That is about the only way you can.

Mr. BELL. Let me make one point clear, Mr. Reuss. The impact of Federal spending on the balance of payments is the precise point that the President has instructed us to pay attention to. I do not know whether we can at this point promise to give you full-scale projections of the balance of payments, in the sense of guessing at the level of imports and exports in all fields and so on. I think there is something perhaps intrinsically more difficult about that than making straight budget projections, because you are guessing not only at the level of economic activity in our country but also at the level of activity in numerous other countries.

Representative REUSS. Surely there is that important difference between them.

Mr. BELL. Yes, sir. So while it is clearly not a matter to baffle the mind of man, to produce something that is reasonable and can be defended, nevertheless there would have to be a great many assumptions in it. I will be glad to talk to Secretary Dillon about this, but I am not sure that he would want me today to commit us to putting before you a thoroughgoing and formal projection of the entire balance of payments.

We are, however, as I indicated, instructed by the President to work on the question of the impact of the Federal budget on the balance of payments and we certainly will be in a position to put before you in the future better data than we can today on that subject.

Representative REUSS. I know that the impact of the Federal budget may seem marginal to the total balance of payments, but I still don't see how you are going to evaluate that impact unless you do make a valiant attempt to bring these imponderables down to earth.

For example, I presume that if we are going to be in a state of imbalance, we should be spending fewer dollars than if we have a surplus in our balance of payments. I therefore see no escape from the rigorous exercise which has been wished upon you, and which I am glad has been wished upon you.

Mr. BELL. I think you are probably right, sir. You may find us reluctant to state publicly and to try to defend some of the guesstimates that we will have to make in this kind of exercise. Nevertheless, I am sure you are correct, that we will have to have working assumptions as to what the balance of payments will look like before we can weigh a given change in the Federal activities against it.

Representative REUSS. I might say in conclusion—because my 10 minutes are almost up—that if your guesstimates should involve sensitive matters affecting policy toward other countries, I am sure the

Joint Economic Committee would cooperate in seeing to it that our dialog is held in executive session.

Mr. BELL. Thank you, sir.

Representative REUSS. Senator Bush.

Senator BUSH. In making your guesstimate, as you call it, on this balance of payments curve, you take into account your projections of balance of trade figures and likely interest rate levels, I presume?

Mr. BELL. Yes, sir.

Senator BUSH. And other economic factors?

Mr. BELL. Yes, sir.

Senator BUSH. Is it not also true that you do have a very important psychological factor to deal with there?

Mr. BELL. Yes, sir.

Senator BUSH. It is almost impossible for you to estimate the importance of that factor, isn't that true?

Mr. BELL. Yes, sir, it is. As you know, one can to some extent divide the balance of payments as between some more solid elements—long-term capital movements and some of the fairly stable elements of the balance of trade—as contrasted with some of the highly volatile short-term capital movements back and forth which rest very heavily on the sort of thing which you just referred to. The psychological attitude of the people who control the balances affected is difficult to assess. It may therefore be possible for us to be somewhat more sure of the underlying longrun estimates we make and very unsure about what may happen in the short-term capital market.

Senator BUSH. I have just two other short questions.

Mr. Bell, you speak of the social and economic needs, education, health, welfare, and so forth, and then say it would be a serious error of public policy as well as false economy to reject these programs on an arbitrary assumption we can't afford them. That assumes that they are all highly desirable or necessary programs.

Here is the point I wanted to mention.

> This Nation can afford higher expenditures, public or private, up to the limit of its capacity to produce—a limit it has not approached for several years.

I want to address my question to this word "capacity"—to the limit of its capacity to produce—and the question in my mind is whether in projecting our potential public sector expenditures we base them on capacity or what I would think is a more realistic thing which is likely performance.

For instance, in coal we have a lot of capacity to produce but we are not going to use it.

Mr. BELL. Yes, sir.

Senator BUSH. The same thing is true in oil. The same thing might be said to be true in homebuilding. We likely could build 2 million homes in a year.

Mr. BELL. That is right.

Senator BUSH. That might be called our capacity, but it would be unrealistic to base your estimates of expenditure on the fact that that is our capacity and therefore we are going to attain it. The same thing is true in railroad transportation. The same thing is true in farm products where our capacity happily or perhaps unhappily is so great that it would be a little difficult or rather it would be unfortunate to place estimates on what we can afford to spend on what the capacity is.

Mr. BELL. Yes, sir.

Senator BUSH. I wish you would comment on that. I don't think I could agree with that statement. I don't think we can afford to spend up to the limit of our capacity to produce. What does that statement mean to you?

Mr. BELL. The word "capacity," Senator, is not used here in the sense you have just been describing. It is intended to refer to the reasonable expectation of what we could do without going all out. This is a point which Mr. Heller has made to me when I have asked him the same question you have just asked me. I assume he has made it before this committee, although I have not read his testimony.

Senator BUSH. I don't recall that we discussed it with him. It may have gone past me.

Mr. BELL. The key point is that for the last several years we have clearly been producing below what could be produced with the plant, with the workers, with the hours of work which are normal, in other words without going to a kind of wartime double shifting or triple shifting situation.

So that the estimate, which is referred to here on the next page, that the American economy was capable in calendar 1960 of an output of $535 billion in contrast with the $503 billion which was our actual product, this is intended to represent not capacity in the sense you were talking about at all. In fact, if we were in some kind of serious wartime emergency, the output could have been a great deal larger than $535 billion in the ways you have just referred to, by pulling in workers whom we do not count as part of the labor force, by running factories triple shifts, and so on. So what we have tried to say here is only that with perfectly reasonable assumptions, the economy can produce a good deal more than it has been producing; that this would permit, if we chose, if we considered it desirable, additional public expenditures or additional private expenditures.

The question of where we put additional resources is a matter of choice. Obviously, it is a matter of judgment on which there will be some differences. The President has recommended some increases in public outlays at the present time. Whether this should be done, of course, is a matter about which there can be differences of view. It was our intention here to indicate that we clearly can afford or could afford, if we wished to, additional outlays on the scale that the President has recommended, without running into any kind of serious limits on our productive capacity. This was all that was intended to be stated in this paragraph.

Senator BUSH. That is a little bit different interpretation than one would put on it from just reading this, I think.

Mr. BELL. I think this is a very good point. I certainly, myself, in the future will be very careful about that word "capacity." I think you have a very good point.

Senator BUSH. Thank you for the explanation. That is very helpful.

Finally, I want to go back to my other question simply to get this thing clearly in mind. This has to do with the recovery which we hope is in prospect if it has not already come. There seems to have been some indication in retail sales, very encouraging indeed, for the last 2 or 3 weeks. And there have been other indications of a minor nature that the upturn has come.

As you say, the figures are behind us 2 or 3 weeks and some of them nearly a month. Would you agree that the actions that the administration has taken to date would have had a minor effect, if any, upon the recovery which has been taking place?

Mr. BELL. If I might, Senator, I would answer that in two segments. First, the direct increases in Federal programs I would agree so far have been relatively small.

Senator BUSH. They have not had a chance to take hold?

Mr. BELL. That is right. One the other hand I think it is significant that the President's position has been so clear and strong from the beginning. In his economic message early in February, he stated clearly that he was prepared to recommend whatever was necessary, that this was a recession which we need not stay in. We should definitely expect to get out of it. He was recommending certain steps which would help now. If more was needed he would recommend more. This, I should think, would have some very useful effect in encouraging people and improving the confidence of the business community, and so on.

Senator BUSH. So the effect is largely psychological?

Mr. BELL. Yes.

Senator BUSH. And I am not seeking to discount the importance at all. We would agree that so far the effect of actions taken has been psychological?

Mr. BELL. Yes.

Senator BUSH. The effect of the unemployment compensation payments will be real in the course of the weeks immediately ahead, I hope.

Mr. BELL. Yes, sir.

Mr. TURNER. There is one point that we should add, which was made by the staff of this committee in the staff report a little over a year ago, and that is that the economic impact of a step-up in Federal expenditures occurs well before the money is actually paid out. It occurs when contracts are placed and when the suppliers against those contracts themselves begin to place orders and to hire people.

Simply to look at the timing of Federal expenditures misses that point. So a step-up in a number of Federal expenditures programs, even though not reflected in expenditures until the summer and fall, has its impact now.

Senator BUSH. It has its impact because it is reflected in expenditures at the operating level, so to speak.

Mr. TURNER. Yes, sir.

Senator BUSH. After all, we have not had the program so that there probably has not been any effect from that angle to date this year.

Mr. BELL. Except insofar as the President's instructions to his various Cabinet officers and agency heads, to move forward procurement and construction within the limits of the funds they had available; that has helped to some extent.

Senator BUSH. I see your point and it is a good point.

Senator PELL (presiding). Mr. Javits?

Senator JAVITS. In the development of a full economy based on the full utilization of productive facilities, have you people worked out a blueprint for that? I will tell you what I have in mind.

You have on the one hand a problem of raw materials. The United States uses enormous quantities of raw materials which we now have to import. This is an accelerating trend all the way. In addition, you have a foreign trade drive on which is counterbalanced by a certain protectionist caste of domestic opinion, including a most disquieting and disconcerting of labor unions, traditionally the friend of international trade, with a section of the economy which produces greater trade and exports still to be heard of, probably in some kind of delayed reaction. This is only two. Others are accelerating the international imbalance of our payments.

Have you people done as yet enough thinking so that we could get from you some paper or planning document which would be permissible to use—I am not trying to pry into the relationship between yourself and your bos—which would show us how we go about this and what happens when we do?

Who is going to use all that we produce? Bearing in mind that if you were a complete autarchy, it could be used at home and happy we would be indeed, but we are not.

Mr. BELL. No, sir; I do not have any such document on my desk. I wish I did. I think we look to the Council of Economic Advisers as the key place to take the lead in thinking in these terms. We will be participating with them through the year and trying to do much more forward planning, and over a longer time scale into the future, than it has typically been done in the past.

But as of today, I don't think we can give you a very satisfactory answer to your question.

Senator JAVITS. Then isn't it fair to say when you talk about $535 billion—and mind you, I am on your side, I am very optimistic and I am a great believer in just the kind of constructive things we have been discussing and I shall vote for them—it is fair to say, is it not, when you talk about that you are voicing an aspiration? Nobody has really boiled it down so you know precisely how we are going to plan for that kind of economy, or what we have to do in order to achieve it.

Mr. BELL. I think that is right; yes, sir.

Senator JAVITS. That is fair. I am certainly not saying it as a critique. I think you all know that.

Mr. BELL. Yes, sir.

Senator JAVITS. We might as well know where we are.

Mr. BELL. That is right.

Senator JAVITS. Wouldn't you agree with me that some such approach as I have described of beginning to chart this in terms of at least national goals and aspirations and specifications would be, certainly for the near term, highly desirable, even if we can't demand it of you today?

Mr. BELL. I thoroughly agree. This is very much what I had in my mind in response to an earlier question of Senator Pell as to the likelihood that by the end of the year we may have gotten ourselves pretty well out of the recession but we won't necessarily by then have gotten ourselves out of our long-run slack posture, nor can we be sure we will have achieved a satisfactory long-term rate of economic growth.

These matters are still on all of our agendas, the Congress, the executive branch, and the private economy. We do not have a clear vision yet of the various interrelated steps that will be necessary to achieve those ends.

Senator JAVITS. We don't even have adequate machinery. Wouldn't you agree that the labor-management council or conference at the White House is good, but it certainly is just a beginning of the kind of body of opinion we need for the development of these concepts?

Mr. BELL. We hope it will be a useful start; yes, sir.

Senator JAVITS. Thank you, Mr. Chairman.

Senator PELL. Mr. Bell, I was very interested in your statement where you compare the change of the 1961 budget estimate of the former administration with the 1961 budget estimate of the present administration. Am I correct in understanding that the total increase stemming from the new policies of this administration will only be $1.4 billion, not counting defense?

Mr. BELL. Yes, sir, that is right. Until today increases of $2.3 billion in expenditures are offset by an anticipation of higher receipts of $900 million connected with additional expenditures.

Senator PELL. That is assuming the passage of the various administration proposals?

Mr. BELL. Yes, indeed.

Senator PELL. Thank you very much, Mr. Bell.

Senator JAVITS. May we pin down this $900 million? This is an estimate based on how the economy will be stimulated. That is no ascertainable source of income like new taxes?

Mr. BELL. No, sir. This is the existing tax structure.

Senator JAVITS. That you believe will be generated by what you put out?

Mr. BELL. Yes, sir.

Senator JAVITS. That is your best belief?

Mr. BELL. That is right.

Senator PELL. Thank you very much, Mr. Bell. We all thank you for coming.

Mr. BELL. Thank you, sir.

(Whereupon, at 12 o'clock noon, the hearing in the above-entitled matter was recessed to reconvene at the call of the Chair.)

JANUARY 1961 ECONOMIC REPORT OF THE PRESIDENT AND THE ECONOMIC SITUATION AND OUTLOOK

MONDAY, APRIL 10, 1961

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

The committee met, at 10 a.m., pursuant to call, in room 318, Senate Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Bolling, Griffiths, and Curtis; Senators Proxmire, Douglas, Pell, and Bush.

Also present: William Summers Johnson, executive director, John W. Lehman, clerk and deputy executive director.

The CHAIRMAN. The committee will please come to order.

We are continuing hearings on the Economic Report of the President, and on the economic situation and outlook. Dr. Heller and the other two members of the Council, Drs. Tobin and Gordon, have been good enough to come back for questioning. Dr. Heller, if you or the other members have anything you wish to say, you may proceed in your own way, or do you wish to begin with the questioning? It has been suggested that since Representative Curtis has submitted questions in writing to you, Dr. Heller, that you take up the questions and at this point in the record, insert Mr. Curtis' questions and your answers, and if you wish, you may amplify on any of the answers.

Representative CURTIS. Mr. Chairman, my understanding is that these questions that I have propounded in writing will go in the record here.

The CHAIRMAN. At this point.

Representative CURTIS. And the written replies of Dr. Heller and the Council will go in right after that, and now we are going to amplify that.

The CHAIRMAN. Yes.

Senator BUSH. May I ask a question there, Mr. Chairman? I believe the paper I have shows the questions followed by the answer in each case. That being so, I think that would be more appropriate than to have the questions all listed first.

Representative CURTIS. I agree.

The CHAIRMAN. It is understood that we put the whole statement in the record at this point, questions, and answer following each question.

Senator BUSH. As presented by Dr. Heller in this paper, entitled, "Replies of the Council of Economic Advisers to questions submitted by Hon. Thomas B. Curtis," we see on the first page question No. 1 and this is the answer.

The CHAIRMAN. Without objection, it will be inserted now.

(The document referred to follows:)

REPLIES OF THE COUNCIL OF ECONOMIC ADVISERS (WALTER W. HELLER, CHAIRMAN; KERMIT GORDON, JAMES TOBIN) TO QUESTIONS SUBMITTED BY THE HONORABLE THOMAS B. CURTIS

Question 1: "On page 4, it is stated that the President has expressed his intention to 'return to the spirit as well as to the letter of the Employment Act of 1946,' and to have the economic reports 'deal not only with the state of the economy but with our goals for economic progress.' The use of the verb 'return' presupposes that there had been an abandonment of the spirit of the Employment Act.

"Will you clarify this point? Just what is your conception of the 'spirit' of the act; what is the basis for assuming that your conception is the 'spirit' of the act if it goes beyond the 'words' of the act? Wherein do you feel that this spirit had been abandoned in the past?"

The Employment Act of 1946 specifically requires that the President's Economic Report set forth "the levels of employment, production, and purchasing power obtaining in the United States and such levels needed to carry out the policy declared in section 2 [which pledges the Federal Government to promote maximum employment, production, and purchasing power]." Since 1953 the Economic Report has not set forth the "levels needed." Chairman Arthur F. Burns argued in a statement to this committee in January 1955 that the act requires no more than "as good a specification of objectives, whether in terms of numbers or otherwise, as can be made." Whether or not this is a proper interpretation of the letter of the act, we believe that the spirit of the act is better served by quantitative estimates of the capabilities of the economy. These estimates, although subject to inevitable imprecision, are yardsticks against which the administration, Congress, and the public can appraise the current performance of the economy and consider future policies and plans.

Question 2: "On page 5, it is stated, 'Further, the President has stated that we should not "treat the economy in narrow terms but in terms appropriate to the optimum development of the human and natural resources of this country, of our productive capacity and that of the free world."' There is an implication in this statement that the past treatment has been 'narrow.' Will you clarify this point? Where in the past has the economy been treated in narrow terms and in what particular specific ways is the Council now broadening the treatment?"

The quoted statement was made by President-Elect Kennedy at his press conference of December 23, 1960. He went on to say that he would look to the Council for advice "in the major fields of economic and social policy with which the administration will be concerned." At a later point in the same statement President-Elect Kennedy indicated that he might ask the Council to undertake new responsibilities in such fields as natural resources, consumer problems, and manpower.

The President evidently envisaged the Council's advisory role to embrace new fields of interest, which lay outside the range of major concerns and assignments of previous Councils.

Question 3: "On page 6, it is stated, 'The fourth recession has thus far been shallower than its predecessors. But the gentleness of the current decline is small consolation, because the descent began from relatively lower levels. The previous recovery was abortive, and the recession began with an unemployment rate which earlier recessions did not reach for 3 to 6 months.'

"What is meant by 'began from relatively lower levels,' relative to what? Lower levels of what? What is the basis for the use of the adjective 'abortive'? If these statements are based solely upon the model set forth later in the statement in respect to attainment of economic capacity, merely so state, but if there are other bases for the statement please set them forth."

The statements regarding the "abortive" character of the previous recovery and the "relatively lower levels" from which the recession of 1960 began are based on the evidence presented in table 2 regarding unemployment, and on the estimate—shown graphically in chart 4—that even in the peak quarter output was 4.4 percent below potential. Although recovery from the trough of April 1958 proceeded briskly for 1 year, it did not carry the economy to satisfactory levels after the steel strike of 1959.

Question 4: "On page 8, it is stated that disposable income grew at an annual rate of $8.9 billion more than GNP and reference is made to inventory declines. Then it is stated that, 'The prospects of reversal of the recession in the first two quarters of this year depend, therefore, on modest advances in components of demand other than inventory change.' How does this jibe with later proposals to increase disposable income at a faster rate as an anti-recession measure? Doesn't this suggest that disposable income is not a basic factor in the recent recession? Contrary to the suggestions in the next paragraph which refers to the need of 'increases in consumer spending?' Do you distinguish between the terms 'disposable income' and 'consumer spending?' Isn't it true that the present level of living of the bulk of our people has made these two terms no longer interchangeable, if indeed they ever were?"

The course of disposable income was not, the Council agrees, a basic factor in the recession of 1960–61. Indeed, as the cited passage of the Council's statement indicates, the maintenance of disposable income has moderated the recession. Even though the recession cannot be attributed to a decline of consumer spending, an increase in consumer spending—induced by a rise of disposable income—can contribute to recovery. Recovery does not require that each kind of spending rise as much, and only as much, as it fell in recession. One kind of spending can substitute for another. It is the aggregate that counts. In a growing economy aggregate spending must rise more in each upswing than it fell in the preceding downswing. There is no inconsistency in according to inventory decumulation a major role in the recession while advocating measures to increase consumer spending as an aid to recovery.

The terms disposable income and consumer spending are by definition not interchangeable. The difference between them is personal saving. Personal saving generally runs at a rate in the neighborhood of 7 percent of disposable income. The relationship of consumer spending and saving to disposable income is close but certainly not invariant. There is no surer way of inducing a rise in consumer spending than putting more income at the disposal of consumers, especially consumers whose spending has been limited by unemployment or other financial reverses.

Question 5: "On page 9 it is stated that the personal saving ratio of the last half of 1960 was 'abnormally high.' It was unquestionably high, relatively, but why do you regard this as 'abnormal'? This rate has occurred in the immediate past and is less than in some other industrial countries. If it is 'abnormal' for 1960, do you believe that that abnormality might become the norm? Do you believe that this rate of saving is economically bad or good? Would you encourage this high rate of saving through public monetary and fiscal policies, or would you discourage this rate?

The term 'abnormally high' was used in regard to the personal saving ratio in the second half of 1960 to mean unusually high in U.S. postwar experience. The average for the years 1947–60 is 6.9 percent; in 1960, the ratio was 7.5 percent, and in the second half of the year 7.9 percent. Perhaps personal saving will return promptly to a more usual ratio to disposable income. Perhaps the personal saving ratio will remain high in 1961 or longer. No one can be sure at this time.

No value judgment about the personal saving ratio was intended by the use of the word "abnormally," and the Council offers none now. The personal saving ratio is the result of decisions freely made by the Nation's 53 million households. The personal saving ratio is—in the short run at any rate—a fact of life to which the Government's economic stabilization policy must adapt rather than a quantity that can be directly influenced.

Strength in consumer spending would be a welcome stimulus to our economy, which is suffering from inadequate demand. But a low saving ratio is not a sine qua non of recovery if investment or public expenditure expand sufficiently.

The higher the personal saving ratio, the more the burden of restoring and maintaining full employment falls on investment demand. If investment demand is to expand sufficiently, both the tax system and monetary policy must provide adequate incentives to investment. There are advantages to a sustained prosperity of this kind. A high-investment economy is likely to be a high-growth economy. High personal saving can contribute powerfully to economic growth, but only if the thrift of the population is translated into real capital formation and not into unemployment.

Question 6: "On page 9, it is stated that the financial position of the State and local governments is 'deteriorating.' What is the basis for this statement which is certainly contrary to the fact of the rapid development of State and local expenditures vis-a-vis Federal governmental expenditures in recent years? (It would be helpful if the hypotheses which become the basis for important conclusions were set forth straightforwardly as hypotheses instead of in the form of participle clauses as uncontroverted premises upon which other conclusions are based.)"

The main evidence for the deteriorating financial position of the State and local governments is the growth of their deficits and their debts. These deficits (calculated on national income and product account) rose from an annual average of $0.4 billion in the period 1948–50 to an average of $2 billion in 1958–60. The Commerce Department projects a deficit of $3 billion for 1961. The total debt of States and localities rose from $18.5 billion in 1948 to $67 billion in 1960.

A State or local government is constrained in its ability to borrow by the market's evaluation of its debt-carrying capacity as based on its revenue-raising possibilities. Furthermore, many of these governmental units are subject to constitutional debt limitations. There is a serious danger that their increasingly difficult debt situation, together with their inability to increase their tax revenues sufficiently, will act to choke off some of the expenditure they urgently need to make.

The "rapid development of State and local expenditures," far from contradicting our assertion of growing financial weakness, is a prominent cause of that weakness. The States and localities have very properly responded to the need for better educational and hospital facilities, urban redevelopment, mass transportation, etc. They have not been able to afford to do enough in the past, and the needs will grow in the future.

At the same time, their revenues do not grow with GNP to the same degree as do Federal revenues. Moreover, a State or locality is inhibited from imposing a new or increased tax by the fear that economic activity will flee its borders, thus complicating its revenue problem.

Question 7: "The premise for much of the economic philosophy advanced in the testimony seems to be an alleged gap between actual and potential output of our economy. Is this a fair statement?"

The economic philosophy underlying the Council's testimony is independent of the gap. But the diagnosis of present economic difficulties advanced in the testimony is indeed based on our finding that actual output falls short of potential output.

Question 8: "(*a*) Do you recognize any limitations to the gross national product as a meaningful series of statistics in measuring economic potential? If so, please set forth what these limitations are and what we must guard against in relying upon GNP in obtaining a meaningful picture of our economy. (*b*) Specifically, do you believe that GNP is valuable primarily as a long-range measure of economic growth and economic capabilities? (*c*) If not, how do you take account of economic mistakes which become just as much a part of the GNP of a particular year as economic activities that prove to be fundamentally sound? (*d*) Do you recognize a difference in an economy based upon war and one based upon peace, particularly as measured in terms of GNP? (*e*) Do you recognize a difference between an economy that is becoming industralized and one that has been industrialized for some time in using GNP as a method of measuring the further advancements of both economies? (*f*) Do you recognize a difference between an industrialized economy that has had its industrial plant largely destroyed by war and is rebuilding with an industrialized economy that has not had this experience in using GNP as a method of measuring the further advancements of the two different kinds of economy? (*g*) Do you believe that as an industrial economy develops and advances technologically that there is a shift from manufacturing to service and distribution? (*h*) If so, do you recognize a limitation in the use of GNP as a measurement of economic development to reflect this shift? (*i*) Do you believe that the U.S. economy is experiencing a noticeable shift in economic emphasis from manufacturing to service and distribution? (*j*) Do you believe that money spent in research and development and in education is measured with the same weighting that money spent on capital expansion such as more steel capacity by the GNP statistical series?"

(*a*) Gross national product, like any aggregative index of economic activity, is an imperfect measuring rod. Most of its limitations are inherent in trying to describe a complex economic system by a single number. Inevitably much that is important and interesting is left out. Other difficulties and limitations stem from:

1. The very concept of production (e.g., the omission of leisure), the exclusion of many nonmarket activities (e.g., the services of housewives), and the necessity of imputing values to other goods and services that do not pass through the market (e.g., the services of owner-occupied homes).
2. The often tenuous distinction between final and intermediate output (in particular the treatment of Government expenditures, the replacement of plant and equipment, and research and development expenditures).
3. Questions of valuation and price correction, and the related problems posed by product changes.

Despite these difficulties, we believe, in common with the overwhelming majority of economists, the GNP corrected for price change is the best overall measure of economic activity that we possess.

(*b*) Each of the difficulties mentioned above becomes more substantial as the time scale of comparisons is lengthened. For this reason GNP, like any summary measure, is a safer guide to short-range comparisons than to very long range ones.

(*c*) A basic principle underlying GNP computations is that goods and services are valued at market prices. The economist does not presume to substitute his judgments about the relative worth of things for the market's judgments. Expenditures which, with the advantage of hindsight, may be seen to be misdirected are nevertheless included in the national product. So are expenditures which yield greater benefits than are foreseen on the market. This problem does not seem to us to be a serious one to the user of GNP data—first, because we do not believe "mistakes" of valuation to be quantitatively large, and second, because, unless their magnitude changes markedly from year to year, comparisons over time will not be affected.

(*d*) There are several differences between wartime and peacetime economies with respect to GNP measurement:

1. Military goods are not always priced on a free market, and price control and rationing may be introduced even for civilian goods. For this reason the problem of appropriate valuation may be especially severe in wartime.
2. Military commodities are essentially destructive or defensive and do not contribute to social welfare in the same way as ordinary peacetime goods and services. They should not therefore be omitted from GNP. After all, economic output is not all there is to social welfare, and GNP purports only to measure economic output. Moreover, even in peacetime we count regrettable necessities, like police departments, as contributions to national output.
3. In normal peacetime conditions a strong case can be made that net national product, which makes proper allowance for wear and tear of durable equipment, is a more appropriate measure of aggregate output than GNP. It is not often used because of the unreliability of estimates of capital consumption. But in wartime, when the short sprint is of prime importance, it may be desirable to consume capital in order to maximize military potential. In this case GNP is the appropriate measure.
4. In the Second World War, one source of the rapid rise in GNP was the extraordinary increase in the labor force and in hours worked, in response to the national emergency.

(*e*) The two most important distinctions between industrializing and already industrialized economies with respect to the use of GNP are these:

1. The relation between NNP and GNP will differ. The larger and older capital stock of an industrialized country makes it necessary to charge a larger share of GNP to capital consumption.
2. A country becoming industrialized will normally experience a transfer of many productive activities from the nonmarket to the market sector

of the economy, and this will distort GNP comparisons over time. For already advanced economies this source of difficulty does not seem to be very large.

(*f*) War destruction and reconstruction offer no fundamental problems to the user of GNP statistics. They have, of course, important economic effects, but these are reflected in the size, composition and rate of growth of GNP and could be analyzed in normal ways.

(*g*) and (*i*) It is often claimed that, as an industrial economy develops, there is a shift from manufacturing to service and distribution. The facts in the United States since 1929 are far from clear. It is certain that during that period the part of the population engaged in agriculture declined sharply and the part engaged in government and government enterprises increased sharply. Eliminating these two sectors from the total, one can roughly divide the remaining industries into a commodity-producing group and a distribution-and-service group. Between 1929 and 1953 the first group increased while the second decreased (in terms of fraction of persons engaged), and between 1953 and 1959 the reverse was true. Between 1929 and 1959 there is almost no difference in the distribution of the working population between the two groups. The shift to services since 1953 may represent a new long-run trend, or it may simply reflect the development of general slack in the economy.

(*h*) The great merit of GNP as a measure of overall economic activity is that it is not affected by a shift of final demand from one kind of output to another. Equal market values are counted equally in all sectors of the economy. This is not true of other production indicators, which emphasize particular sectors—e.g., the industrial production index. To the extent that there is a shift to services, the major problem with respect to GNP arises from the public sector, which is increasing in importance. Since the services of Government are not generally sold at a market price, the convention has been adopted of measuring their value by their cost. Any increase in the productivity of general government is thus underestimated. It follows that the rate of growth of an economy in which general government is growing relative to market output is somewhat understated by the rate of growth of GNP.

In addition, as already noted, it is sometimes argued that much of government expenditures on goods and services consist of intermediate rather than final uses. The standard examples are the commercial use of roads and the provision of police protection for business property. If it were true that the advance of productivity is inherently slower in service than in manufacturing, the shift to private services since 1953 might account in part for the indicated slowdown in growth.

The facts are difficult to disentangle. The staff of this committee has produced figures which show that between 1947 and 1953 productivity increased in the service sector at an average annual rate of 1.8 percent and in trade at 2.4 percent. Between 1953 and 1958 (1957 for trade) these rates fell to 1.5 percent and 1.4 percent; and between 1955 and 1958 to 0.8 percent and 0.1 percent respectively.

Before we leap to any interpretation of these facts we should note that there was a parallel reduction in the rate of productivity increase within manufacturing. Between 1947 and 1953 manufacturing productivity rose by 3.3 percent per year and from 1953 to 1957 the rate of improvement fell to 1.9 percent per year. Moreover, it is possible that the poor performance of the service and trade sectors after 1955 does not reflect an inherent sluggishness in productivity. Instead it may be that general weakness in the economy released workers from relatively high-productivity employment in all sectors and left them to be absorbed in low-productivity and low-wage employment in services and trade.

Since the shift in resources to services after 1953 was small, and since the productivity growth differential was also small in those years, this factor cannot account for more than a very small fraction of the slowdown in overall growth of GNP.

(*j*) There is indeed an anomaly in the treatment both of education and of research and development in the national accounts. Both types of expenditures are in large part a kind of capital formation, indeed an important kind of capital formation; yet both are treated as current expenditures. Public education, as noted, enters into the measured GNP simply at cost. Private research and development expenditures, except for buildings and equipment, are treated as current expenses by business firms. They enter into GNP only indirectly as they are reflected in the value of final goods and services, but do not themselves appear as final product. Since the volume of research and development expenditures is growing more rapidly than GNP, the result is to underestimate somewhat the rate of growth of national product. But since the absolute volume of such outlays is small relative to GNP, the amount of the underestimate cannot be great.

Question 9. "Do you agree that the CPI has an upward bias resulting from the difficulties in measuring increases in quality and choice of goods and services? If so, do you not believe that the adjustment of GNP in 1960 or the current year prices will reflect this bias and so not give us as accurate a picture of real GNP for the particular year as GNP unadjusted?"

The Council said in the March 6 statement: "* * * as noted in the report of the Price Statistics Review Committee, which the Joint Economic Committee has just published, many experts believe that the price indexes, by failing to take full account of quality improvement, contain a systematic upward bias." Unless the extent of the bias varies widely from year to year, it will not seriously distort comparisons of rates of growth. The Consumer Price Index is not used to "deflate" GNP for price change. This "deflation" is done by special price indexes with appropriate weights, one for each major GNP component. These indexes are subject to the same sources of upward bias as the CPI. But it is certain that this bias cannot be so large or so erratic that undeflated GNP would be a better measure of changes in real output. Genuine changes in the general price level are often very substantial and vary widely from year to year. In common with nearly all economists, we believe that deflated GNP gives a more accurate picture of real output and its changes than current-price GNP.

Question 10: "In the model to demonstrate potential output you refer to unemployment as 'wasted economic potential.' This seems to ignore completely the economic forces (capital formation, business organization, trained labor force, research and development, invention and discovery) that are necessary in order to give meaningful employment to workers. I would appreciate your comments upon this observation and I would ask that these observations be made in context with the manner in which you have built upon this model of so-called unused potential. Do you agree that in a growing economy there will always be an incident of unemployment? If so, why do you not adjust for this when you build upon unused potential in your model?"

Unemployment at any time on the scale that now exists in the United States is "wasted economic potential." In addition, at the present time there exists substantial unemployed capital in the form of excess capacity in many industries throughout the country. For example, in February 1961 overall metal production was running at only 55 percent of capacity, as against 72 percent in May at the peak of the current business cycle, and an average 99 percent in 1951. In textiles the comparable figures are 70 percent, 84 percent, and 96 percent, respectively, while in pulp, paper, and paperboard these figures are 82 percent, 87 percent, and 90 percent. Unemployment and excess capacity together constitute therefore a major economic problem. We have estimated that the current gap between actual production and potential is of the order of $50 billion. This estimate is based not only on the visible evidence of unemployment and excess capacity, but also on our confidence—reinforced by the experience of previous recoveries—that the necessary business organization and know-how would be forthcoming if aggregate demand were sufficient.

Question 11: "Do you believe that the faster an economy grows the greater is the incidence of unemployment?"

This hypothesis is not borne out by recent U.S. economic history. Years in which gross national product grows at a good rate tend to be years in which unemployment declines. Years of increasing unemployment tend to be years in which gross national product is stable or declining.

Rapid technological progress tends directly to increase employment in the production of new plant and equipment. At the same time, rapid technological progress which causes major shifts in the pattern of production will often generate temporary unemployment in particular industries, localities, or skills. This unemployment may become chronic if the economy is not growing rapidly enough to reap the full gains of technological advance. So long as overall demand for labor remains strong, the displaced workers will be absorbed into areas of expanding employment. Public programs to facilitate labor mobility can make an important contribution to the process by which the labor force adapts to dynamic growth.

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Question 12: "Do you believe that as an economy grows technologically the need for unskilled and semiskilled workers becomes less? If so, why do you not relate the high rate of unemployment which exists among the unskilled and semiskilled, the new entrant and the old entrant to this rapid technological growth in our society?"

It is clear that the composition of employment and the labor force has been shifting against unskilled and semiskilled workers. But in our earlier prepared testimony, we were dealing with changes in the rate of unemployment in recent years, and we found evidence that recent increases in the incidence of unemployment among unskilled and semiskilled workers were not out of line with the experience of other occupational groups. During the whole postwar period (and in 1940 as well) unskilled and semiskilled workers have experienced relatively higher rates than other occupational groups. That is not a new phenomenon. Moreover, we believe that the pattern of labor supply can in time, and in a favorable economic environment, adapt to the patern of demand. If the demand for skilled and white-collar labor were more active, more transfer into these groups would occur. In a thriving economy, structural decreases in employment are not the same thing as increases in structural unemployment.

Question 13: "I have suggested (speech, February 17, 1961, pp. 5–9) that the problems we experience in the area of unemployment, far from being those resulting from a tired, sluggish, or sick economy, are primarily the result of an economy that has been growing so fast we have growing pains. I am enclosing a copy of that speech. I would appreciate your observations on this aspect of the speech."

We certainly do not believe that the U.S. economy is tired, sluggish, or sick. Its potential is enormous, but we cannot be satisfied with our recent economic performance. It is imposssible to accept current levels of unemployment as simply the growing pains of a rapidly growing economy because there is no independent evidence that the economy is growing rapidly. Progress in invention, science, and management skills do not themselves constitute rapid growth. They represent a great potential for growth, which it is the responsibility of private initiative and public policy to realize. Otherwise we will have growing pains without growth.

Rapid growth both creates, and helps to solve, problems of economic adjustment and adaptation. Dynamic growth inevitably entails redundancy of some skills and specialized capital, while at the same time creating demands for new skills and new capital. The long-term growth record of the American economy is evidence that we have solved these problems in the past, and we are confident that we can continue to solve them in the future.

Question 14: "The Chairman of the Federal Reserve Board testified before the Joint Economic Committee and he gave a picture of the economics behind the relatively high incidence of unemployment that many people, including myself, thought was at variance with the one expressed in your testimony. Since then, Mr. Martin has submitted a further statement made after he had a chance of reviewing yours. He states, 'It seems to me that the apparent differences with my testimony (and yours) are mainly ones of definition and emphasis.' With this I agree and I think, far from reconciling the differences, Mr. Martin's further statement confirms the differences in both emphasis and definition to be fundamental differences. Your statement is very positive. On page 15 you state, 'Some have attributed the growth of unemployment in recent years to changing characteristics of the labor force rather than to deficiencies in total demand. * * * Expansion of overall demand, it is argued, will not meet this problem; it can only be met by educating, restraining, and relocating unsuccessful jobseekers.

" 'The facts clearly refute this explanation of the rise of unemployment over the last 8 years.'

"We are primarily interested in examining into the problems of unemployment so that we can apply the proper remedies.. Your analysis suggests expanding overall demand (which I believe you regard as being synonymous with disposable income, which I do not). Mr. Martin clearly does not recognize this as a method of attacking structural unemployment.

"I would be pleased to have your comments."

Our statement and our calculations demonstrated that recent increases in the unemployment rate at cyclical peaks could not correctly be attributed to increases in the extent of structural unemployment. We know of no evidence that contradicts this conclusion and the analysis that supports it.

The Council's statement recognized the importance of structural unemployment. We stated, as did Chairman Martin, that policy should move ahead simultaneously against structural unemployment and against unemployment stemming from weak aggregate demand. We pointed out, as did Chairman Martin, that expansionary fiscal and monetary policy would create an environment in which the pull of jobs in the growing sectors of the economy would attract workers from the declining sectors and areas. Thus, general prosperity contributes to the effectiveness of policies aimed specifically at structural unemployment. Our March 6 statement said:

"Measures to improve the mobility of labor to jobs and jobs to labor, to better our educational facilities, to match future supplies of different skills and occupations to the probable pattern of future demands, and to improve the health of the population—these are and should be high on the agenda of national policy. But they are no substitute for fiscal, monetary, and credit policies for economic recovery. Adjustments that now seem difficult, and unemployment pockets that now seem intractable, will turn out to be manageable in an environment of full prosperity."

The 4-percent unemployment rate we mentioned as a clearly attainable target allows plenty of room for the unemployment stemming from shifting demands and technical progress. The unemployment rate is close to 7 percent now. As recently as February 1960 it was 4.8 percent. A rise in the unemployment rate by 2 percent of the labor force in the short space of a year can scarcely be attributed to basic changes in the structure of the economy and of the labor force. It is the result of the recession, i.e., of weakness in overall demand. Nor can all of the 5 percent unemployment of early 1960 be accepted as hard-core structural unemployment; there is independent evidence that the economy was then operating short of reasonable capacity.

We certainly do not view 4 percent unemployment as a rockbottom minimum. As policies to improve the mobility and the skill composition of the labor force take effect, it will be possible in sustained prosperity to hold the rate of unemployment somewhere below that figure.

Finally, we do not regard overall demand as synonymous with disposable income. Overall demand is the aggregate of spending by government, business, and households. Consumer spending, which is related to disposable income in the manner explained in No. 4, is only one component, though the single largest component, of overall demand.

Question 15: "On page 35, it is stated, 'Monetary policy must at all times be flexible and interest rates must be higher in booms than in recessions.' I am puzzled by the verb 'must be' in lieu of 'will be.' 'Must be' implies some force other than economic forces. Is it your opinion that the Federal Government can set interest rates and that political force is sufficiently powerful to control the economic forces here at play?"

Interest rates are determined by supplies and demands in a set of interconnected markets for loans and securities. The Federal Government—through the Treasury and the Federal Reserve—plays an important role in Government securities markets, determining through its public debt and open market operations the outstanding supplies of securities of various types and maturities. By these operations the Government, if it wishes, can within broad limits offset or reenforce changes in private supplies and demands in Government securities markets and thus affect the interest rates which these markets determine. Interest rates and asset prices in other money and capital markets are linked, some very closely and others quite indirectly, with interest rates on Government securities. The passage cited expresses our view that Government influence in the securities markets should not be carried to the point of eliminating the cyclical movement of interest rates that would follow from fluctuations of private supplies and demands.

Question 16: "On pages 26 and 27 two adjectives are used in relation to the homebuilding sector of our economy which suggest that it is the Council's opinion that the tapering off of homebuilding activity is not a reflection of our economy catching up with demand but something else (undefined). On page 36, it is stated, 'It is difficult to accept the view that the housing market is so glutted. * * *' On page 37 a sentence starts out, 'In the face of a depressed level of homebuilding activity * * *.' What are the Council's views of the homebuilding industry? Do we have less consumer demand? Is supply catching up with demand? It is dangerous to talk about a normal economic phenomenon as if it were 'depressed' simply because it has declined relatively, for valid reasons, unless this is so. It is unfair to refer to those who believe this to be the fact as having said, 'the market is so glutted.' The rate of home building is still high and will continue to be relatively high, though we may count upon it to continue to decline from this high point if consumer demand is indeed being met. What is the view of the Council?"

In referring to the depressed level of homebuilding activity, the Council had in mind the fact that the rate of new private housing starts at the end of 1960 was at a low level when measured against the record of the preceding decade.

Among the factors which help to account for the recent weakness in residential construction were the high level of building activity in 1958–59; the accumulation of inventories of unsold new houses in 1960; and a temporary decline in the expected rate of family formation. In addition, residential construction has been further depressed by high interest rates on mortgages. These factors were cited in the Council's March 6 statement, as explanations of the low level of residential construction at the turn of the year.

While the housing deficit of the 1930's and the war years has been largely filled by postwar construction, and while some traditional sectors of housing demand show signs of continuing weakness, we do not interpret these facts as decreeing a bleak prospect for residential construction. The urgent and clearly visible needs of millions of lower income families for improved housing can be translated into effective demand as the employment situation improves, as economic growth raises incomes, and as homebuilders adapt their production to newly emerging demands.

Lower interest rates can also make an important contribution to an improvement in housing activity. As we stated in our March 6 testimony, "It is difficult to accept the view that the housing market is so glutted that it would not respond to lower monthly financing costs."

Question 17: "On page 39, it is stated, 'welcome as the built-in stabilizers are when the economy contracts, they are a mixed blessing when it expands.' I would suggest that this phenomenon, with which I agree, has more to do with the nature of 'recoveries' than that suggested by the earlier language in this statement, which refers to the previous recovery as 'abortive.' Would you comment upon the built-in stabilizer effects on the present recovery and the past recoveries, in this light."

We agree that built-in stabilizers temper the pace of economic recovery just as they moderate recession. As chart 7 (p. 38) of our March 6 statement shows, the Federal Government fiscal position changed sharply from net deficit to surplus at the beginning of 1960. This change represented partly the effects of built-in stabilizers and partly deliberate policy decisions. This was one of the factors in the premature end of the recovery in early 1960.

Question 18: "On page 41 it is suggested that 'full recovery * * * would generate substantially more revenue than is required by the President's proposed programs, thus leaving a generous margin for retirement of debt and restraint of inflation.' Since this date, the President's budgets have been sent to the Congress. Mr. Bell, the Director of the Bureau of the Budget, has testified before this committee. Obviously, even with full recovery, we will have deficit financing for fiscal year 1961 and fiscal year 1962; without 'full' recovery (whatever that may be), both years will reach new highs of economic endeavor measured by the GNP indicator. Will you comment?"

In our testimony, the term "full recovery" was used specifically to mean a rise in GNP to its potential level, implying a reduction of unemployment to the 1955–56 rate of 4 percent of the labor force. We estimate potential GNP, thus defined, to be $562 billion for calendar 1961. With that level of economic activity, budget receipts for fiscal 1962 would be about $92 billion, far above the $81.4 billion of revenue now anticipated. There is a difference of about $50 billion between potential GNP for 1961 and the GNP underlying current revenue estimates. At potential GNP, corporate profits would be higher by about $13 billion and personal income would exceed the expected level by some $35 billion. As a result, corporate income taxes would yield an additional $6 billion and individual income taxes would be more than $4 billion higher. These are estimates, not precise figures; but even allowing for a large margin of error in our estimates of potential GNP, corporate profits, and personal income, the statement which you quote is correct. With a 4-percent unemployment rate, revenues would substantially exceed the $84.3 billion level of prospective expenditures for fiscal 1962.

The prospective deficit for fiscal 1962 is attributable to slackness in the economy. We estimate that a balanced budget would be achieved if GNP for calendar 1961 were $526 billion, with a prospective unemployment rate of nearly 6 percent. Even so incomplete a recovery is more than can now be reasonably foreseen in 1961. We agree with your expectation that GNP will reach record highs during fiscal years 1961 and 1962. But we call attention to the disturbing fact that the average unemployment rate during fiscal 1961 will be the highest of any postwar fiscal year. Because of the growth in labor force and productivity, output must grow for unemployment to stand still. A record output can be associated with record unemployment. For this reason, we have emphasized that the economic performance of the United States must be evaluated in relation to its capacity to produce. By this standard, fiscal year 1962 will start from a depressed base. Even with the stimulus provided by the administration's antirecessionary programs, it will take time to achieve full recovery.

Question 19: "In light of anticipated deficit financing and a requirement which indicates the need for the public marketing of $8 billion additional Federal bonds in the next 2 years, will this not create inflationary pressures that cannot be controlled under the present state of our economy? What will be the impact of 2 years of deficit financing in 2 prosperous years in respect to our balance of payments abroad and the psychological effect this fiscal policy will have on the nations abroad?"

Deficits do not, in and of themselves, cause inflationary pressures and balance-of-payments difficulties. A high and expanding level of economic activity may, in the absence of vigilant preventive measures, have these unwelcome byproducts. But they are byproducts of the expansion itself, not of its sources. Budget deficits will give rise to these problems only to the extent that the budget contributes to general economic recovery. And, if the same degree of general recovery occurs from exuberant private demands, without help from budget deficits, the same pressures on prices and on the balance of payments will arise. In the present situation of the American economy, if one believes that expansion generated by budget deficits would result in unacceptable risks of inflation and external imbalance, he should logically favor measures to discourage forces of expansion in the private economy as well.

The administration is seeking a vigorous and complete recovery, and is taking steps aimed at preventing expansion of demand from wasting itself in inflationary pressure and deterioration of the balance of payments.

It is not the relation between Federal receipts and outlays, but the relation between total public and private spending and aggregate economic capacity, that determines the strength of inflationary pressures in the economy. Budget surpluses are no guarantee against inflation if, as in 1947 and 1950, private demands for goods and services rise excessively. And in a slack economy, budget deficits do not automatically spell inflation or even full recovery.

Deficit financing of increased public expenditure in the two fiscal years 1961 and 1962, on the scale contemplated, will not create uncontrollable inflationary pressures. Unless private demands are unexpectedly strong, the President's budget will not strain the productive capacity of the economy in fiscal year 1962. The economy is now suffering from unemployment and excess capacity. Increased spending, whether public or private, will result in increased production. Output and employment can expand without appreciable upward pressure on prices and wages. If and when recovery proceeds to the point where the economy is straining productive capacity, further increases in spending, public or private, would increase prices rather than production. Under such conditions, overall demand could be and should be restricted by fiscal and monetary measures

Developments in our economy are watched keenly and critically by other nations. Our economic performance in recent years has elicited widespread concern. American prestige abroad would be raised by a successful program to restore momentum to the American economy. A budgetary deficit would be considered both a normal result of recession and a proper instrument of recovery. Western European nations have generally accepted the need for compensatory fiscal policy. Moreover, many European budgets distinguish, as the U.S. budget does not, between current and capital outlays.

Economic expansion, whether the result of deficit-financed public expenditures or of sharply rising private demands or of both, will increase U.S. imports. On the other hand, improvement in business prospects at home will reduce the net outflow of long-term capital. The President listed in his balance-of-payments message a number of steps to improve the U.S. payments position. One of the purposes of the investment-tax incentive which the administration will propose is to accelerate advances in productivity in order to maintain and improve the competitiveness of American products in world markets. We are determined to balance the international accounts of the United States, but we reject as a counsel of despair the view that only an economy depressed at home can be in balance abroad.

Question 20: "On page 51, it is stated, 'Some excessive price increases in 1955–58 might not have occurred if market control had not been so strong.' What do you mean by 'market control'? Is this another name for the discredited term 'administered prices'? If so, let me ask if the firms having this so-called market control aren't the very firms that spend the most amount of money on market research? And if that is essentially true, isn't it rather conclusive that the market does the controlling and the businesses merely try to estimate the market? During the same period (1955–58) we had one of our most vigorous enforcements of antitrust legislation. Does the Council suggest that the antitrust laws be further strengthened to get at the alleged 'market control' and, if so, in what area? To limit the bargaining power of national labor unions?"

We mean by "market control" the ability of sellers of goods or services to exercise discretion over prices and other terms of sale. The term "administered prices" is sometimes used in this sense.

The degree of market control—the extent of sellers' ability to exercise this discretion—varies widely among product and labor markets. This discretion is never absolute; it is always subject to impairment by the entry of new competitors, by the development of new products or processes, by alterations in the legal bases of market control, by disruption of understandings among competitors, and by a host of other contingencies.

Hence, although many firms which possess a significant degree of market control also spend large sums on market research, the latter fact does not negate the former. Rarely if ever is a firm's position so impregnable, or its sales so incapable of further expansion, that it is not concerned to improve its product, to heighten the effectiveness of its sales promotion efforts, or to find out what its rivals are doing.

The antitrust laws have been used effectively to reduce the degree of market control in particular markets, and they should continue to be so used. The Council is not advancing any proposals for amending the antitrust laws.

The CHAIRMAN. You may take them up, Dr. Heller, and elaborate on any answer you may desire.

STATEMENT OF WALTER W. HELLER, CHAIRMAN, AND KERMIT GORDON AND JAMES TOBIN, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Dr. HELLER. Thank you, Mr. Chairman.

I might say first of all that we are pleased to respond to the committee's request that we appear for further questioning on our testimony of March 6. We do apologize for having selected as between two alternative dates the one that marks the opening of the baseball season. However, we plead ignorance as our defense as of that time. I might say, coming from Minnesota, that I have divided loyalties between ex-Senators and new Senators.

As the chairman has said, Congressman Curtis has submitted 20 questions for our consideration, and we have prepared the written answers which are before you.

As the chairman has suggested, there are some questions on which we would like to present a bit of oral amplification. If I may, I would like to refer first of all to question 5 on pages 6 and 7. Congressman Curtis' question was as follows:

On page 9 it is stated that the personal saving ratio of the last half of 1960 was "abnormally high." It was unquestionably high, relatively, but why do you

regard this as "abnormal"? This rate has occurred in the immediate past and is less than in some other industrial countries. If it is "abnormal" for 1960, do you believe that that abnormality might become the norm? Do you believe that this rate of saving is economically bad or good? Would you encourage this high rate of saving through public monetary and fiscal policies or would you discourage this rate?

The term "abnormally high" was used in regard to the personal savings ratio in the second half of 1960 to mean unusually high in the U.S. postwar experience. The average for the years 1947–60 is 6.9 percent; in 1960 the ratio was 7.5 percent, and in the second half of the year 7.9 percent. Perhaps personal savings will return promptly to a more usual ratio to disposable income. Perhaps the personal saving ratio will remain high in 1960 or longer. No one can be sure at this time.

No value judgment about the personal savings ratio was intended by the use of the word "abnormally," and the Council offers none now. The personal savings ratio is the result of decisions freely made by the Nation's 53 million households. The personal saving ratio is—in the short run—a fact of life to which the Government's economic stabilization policy must adapt rather than a quantity that can be directly influenced.

At this point I would like to add that, of course, in the longer run the savings ratio may respond to the level of interest rates, and the level of interest rates in turn may be affected by Government. Economists do not have firm evidence on this matter. We are not saying that the savings ratio is not subject to any governmental influence, but rather, that in the short run it is difficult, if not impossible, to affect it materially in a direct manner.

Another point that I think is worth adding here is that savings other than personal savings can be influenced perhaps more readily than the personal savings ratio. The business savings ratio can certainly be affected, particularly through the form of business taxation. Likewise, of course, the Government itself can affect aggregate savings through the relationship of its expenditures and tax revenues.

This was the main point I wanted to bring in as an amplification to that question.

The CHAIRMAN. That is question 5.

Dr. HELLER. Yes.

The CHAIRMAN. Have you finished on that?

Dr. HELLER. Yes, sir.

Then, question 6. The question refers to our statement that there is some deterioration in the financial position of State and local governments. We suggest that the main evidence for this deteriorating financial position of State and local governments is the growth of their deficits and their debts. These deficits rose from an annual average of $400 million in the period 1948–50 to an average of $2 billion in 1958–60.

The Commerce Department projects a deficit of $3 billion for 1961. The total debt of States and localities rose from $18.5 billion in 1948 to $67 billion in 1960.

It is quite true that this debt was incurred by and large for sound purposes, and it is matched by assets. We do not mean to imply that the debt reflects an unsound financial procedure. What we are saying is that the growth in the size of the debt and the growth in these deficits suggests that the financial position of States and localities has become somewhat more precarious, as most of us I am sure know from personal experience. The States and localities have been under tremendous financial pressures, and the rest of our answer deals with some of those pressures.

The CHAIRMAN. I would like to comment on that. We are frequently told that the local communities should carry the whole burden of taking care of the aged, educating the young and things like that. I think there is an entirely different situation now as compared to 25 or 50 years ago. The ability of the States, counties, and political subdivisions to carry these burdens is deteriorating all the time.

People in local communities do not have the business opportunities that they used to have, or own the resources. In times gone by, local people would own the local stores and the other local businesses, and the profits would remain at home. The profits could be taxed, and the profits would go in the local bank where they could be lent to local people to be helped in other ways. I am not insisting that all businesses should be locally owned. There are industries such as communications, transportation, electricity, gas and water which cannot be owned locally. But other businesses could be and were owned locally.

In recent years the profits have been drained off. I think the increasing concentration of ownership of business and the absentee ownership has impaired the ability of the States and local communities to raise revenues.

To give a comparison, to bring it into focus, let us take a school district that votes a million dollars in bonds to build a schoolhouse. In that school district the tangible property is taxed. The ad valorem system is used. The people who own their homes and farms and ranches in that school district for the most part really owe for these homes, farms, and ranches. There are mortgages on them, in addition to other indebtedness. So they are not only paying taxes on what they owe, they are also paying the interest on the mortgage. It is a double burden; they pay taxes on what they owe as well as on what they own.

I think it is about the hardest tax system in the world. I have a feeling, Mr. Heller, that problem should be given more consideration. Can't you see a deterioration, from that standpoint, going on in the States, counties, and political subdivisions?

Dr. HELLER. Congressman Patman, that problem concerns us very greatly. By and large, as the economy increases its gross product, the demands made on State and local governments rise considerably faster than the automatic responses of State and local revenues. State and local revenues are very largely based on relatively inflexible sources like property taxes, as you suggest, and sales taxes, whereas at the Federal level, the response of the revenue system to economic growth, that is, to an expansion of gross national product, is more than proportional to that growth. As a result the balance between spending responsibilities and revenue generation is much more adverse to State and local governments than it is currently to the Federal Government.

The CHAIRMAN. The mortgages on this property and the bonds that have been issued for different reasons are usually not held locally, but held outside the community, and frequently outside the

State. The city cannot reach that property for taxation, neither can the county or the State. The Federal Government is the only tax authority that can reach it. I think that should be considered, too, in evaluating the ability of local communities to take care of these expensive problems they have now. They probably could have taken care of them better when the local stores and manufacturing plants were local businesses. When that was true, older people in the community could get jobs if they were able and willing to work.

Now, that the local businesses are branches of national chains, people who reach the age of 40 or 45, can't get a job; nor can they go into business for themselves as they used to, because they don't have these moneymaking opportunities they used to have. At an early age, people can't get employment, if they happen to lose their jobs. Then the local community cannot take care of them for the reasons I have stated.

Don't you think it is reasonable to suppose that the people turn more and more to the Federal Government because it is only the Federal Government that can reach into these different places and tax these properties where the income is received and the wealth is held?

Dr. HELLER. I think this is a factor. As you say, as business spreads its wings and becomes more national in character, it becomes more difficult for the State and local units to tap that business as a source of taxation. It is fair to say, however, that there is no lack of effort to tax at the State and local level. In the 1959 legislatures, for example, more than $1½ billion of tax increases were enacted.

This is one more evidence of the pressure under which the State governments have been operating.

The CHAIRMAN. I know, but that does not tell all the story. Against whom were the taxes imposed? Consumers or just whom?

Mr. HELLER. The primary reliance of State and local governments, as I noted earlier, is on consumption taxes and property taxes. In the 1959 legislatures somewhat more emphasis was put in the increases on the income tax source.

The CHAIRMAN. Don't you consider those the most burdensome of taxes?

Dr. HELLER. As far as the distribution of the taxes by income groups is concerned, the sales and property taxes are surely the most regressive.

The CHAIRMAN. Pardon my interruption. Had you finished your point or would you like to elaborate further?

Representative CURTIS. On this one point, Mr. Chairman, may I say that I am glad that the Chairman has pointed out the importance of this issue. Incidentally, one of the points I had in raising this is that in the original statement of the Council, this position or this statement of the financial position of State and local governments is deteriorating, appeared as a participle clause, as if it were true, and upon that basis many conclusions have been drawn. In fact, the truth or falseness of that particular statement affects a great deal of the legislation that is before this Congress.

The question is, has the State and local financial position deteriorated? It becomes very important. I want to examine into it in some depth. In my judgment, quite the reverse is true in the very evidence that we both look at, from which you draw the conclusion that it is deteriorating, the same evidence seems to me rather positive proof that the opposite is true. That far from deteriorating, it is booming.

Just last Tuesday, the St. Louis City or the metropolitan area of St. Louis, 75 percent of the school bonds that were up for vote by the people passed. Among the 25 percent that did not, you could pick them out individually and see the reasons, and also see that a resubmission of most of them would probably bring about their passage. I was just asking for the indicators that Health, Education, and Welfare puts out each month, where we can follow the marketing of municipal bonds. We see the picture there is a very healthy one. What I am pleading for above all is, let us not beg the question on something as important as this. If State and local financial positions are deteriorating, that is a very important fact.

On the other hand, if it is not, that is, I might say, equally important. I think a great deal more study should be devoted to this question. Frankly I think it is foolhardy to do what the administration is presently asking this Congress to do, without studying this question of whether or not the local and State governments' financial position is deteriorating, without marshaling the facts. The Congress is being asked to do a lot of things on that presumption.

Here the Council of Economic Advisers in its original statement begs the question and hides the issue in a participle clause, instead of putting it out where we can examine into it and determine whether or not it is true.

Mr. Chairman, this is not an easy subject and Dr. Heller is an authority in this particular area. We would do well, I think, as a committee to go into this question in some depth, so that we can fulfill our function as a committee to the legislative committees of Congress, and give our evaluation of whether it is true that the financial position of State and local governments is deteriorating.

One final remark, if I may, on this point. I would like to get a little help for some legislation I have offered for some time to improve the market for municipal bonds by removing the tax imposition on investment trusts that invest in municipal bonds, which prohibits them from passing through the interest free rates. It is the little investor that utilizes the investment trust technique to get his spread in his portfolio. So aside from increasing the market for municipals, we also are creating an equitable situation.

I wish the administration would look at that and see if that is not desirable. We got it passed through the House last time. I think we got it over in the Senate, even. This hits right at this very issue of the financial position of the State and local governments to meet these problems.

The CHAIRMAN. I would like to comment on that. I am going in the opposite direction from the way Mr. Curtis is going. He is going in the direction of more tax exemption. I am going in the direction of less.

Representative CURTIS. Will the gentleman yield for a minute?

The CHAIRMAN. Yes.

Representative CURTIS. You mean you would like to remove the tax exemption that presently exists on municipals?

The CHAIRMAN. Yes; it would be in the interest of the people for it to be removed, because they are actually paying almost as much in interest as they would pay on taxable bonds. That is wrong. The revenue which the Federal Government is losing is really not reflected in interest savings to the local taxpayer.

Representative CURTIS. Then the financial positions of the State and local governments indeed would deteriorate.

The CHAIRMAN. Let us see if it would. I think we need a market for municipal bonds. When I say municipal bonds, I mean bonds of the State, county and political subdvisions.

I had Mr. Daniel Bell, when he was Under Secretary of the Treasury, make a study for me to determine the average difference between interest rates on taxable securities and nontaxable securities. He came up with one-eighth of 1 percent. He testified on this before the Banking and Currency Committee of the House some time ago, and I have an impression that there has been even less difference than that in the recent past. Maybe there has been even a disadvantage on the municipal side, because there is no market. I think that is to the discredit of Congress and to the discredit of everybody in public life, that we would force these people to a market that is really not an organized, open market. They have no protection at all. They just get whatever they happen to be offered at the time, much like the people who used to grow vegetables and send them on consignment to Chicago and other points. As you know, the vegetable growers would frequently get wires back asking for the freight charges. It is not exactly comparable to that, but the point is that we do not have a steady, dependable market for municipal bonds. I would not say it is a fixed market, I could not say that, because I have no proof of it. But I think that it has a lot of the earmarks of being fixed, especially when tax-exempt bonds must have an interest rate of 3 and 4 or 5 percent, which is equivalent to a rate of 8 or 10 percent on taxable bonds for an individual in the 50 percent tax bracket.

I don't see how matters could be much worse for municipal bonds than right now. I think it would be in the interest of the public not to have any tax exemptions. I am ready to go that far. What do you think about that, Dr. Heller?

Dr. HELLER. On the factual side, Mr. Chairman, on the interesting recent study of the National Bureau of Economic Research by Dr. Roland Robinson of precisely this subject concluded that well over half of the benefit of the tax exemption (in an earlier article he said four-fifths), went to the taxpayers in the higher brackets in tax savings rather than to the municipalities and States in lowering of interest rates. In other words, of the loss of revenue to the Federal Government from this tax exemption (according to his earlier findings), four-fifths goes to the taxpayer as a tax reduction, and only about one-fifth shows up in reduced borrowing costs for States and localities.

The CHAIRMAN. Would you insert in your remarks in connection with this matter the study that you have just alluded to?

Dr. HELLER. Yes, I would be happy to put in the exact reference to that study, which I do not have at hand.

(The information referred to follows:)

Roland I. Robinson, "The Postwar Market for State and Local Government Securities," report of the National Bureau of Economic Research April 1960.
Roland I. Robinson, "Factors Accounting for the Sharply Increased Cost of State and Local Government Borrowing," Journal of Finance, May 1957.

Representative CURTIS. On that point, Dr. Heller, of course I think there is a lot of truth in that. On the other hand, if we come through with the tax reform that this administration, I understand, is proposing, that the individual high rates were reduced, that would create a different picture. The essence is whether or not that one-fifth or whatever it is would radically affect the marketing of municipal bonds. I have not read this particular study, but does it devote itself to that question, and doesn't it conclude that a removal of this tax treatment would materially affect the marketing of municipal and local bonds?

Dr. HELLER. Any proposal that might be made for changing or eliminating the tax exemption on future issues of State and local securities would probably need to have coupled with it consideration of other methods of providing some support to the State and local bond borrowing operations.

Representative CURTIS. With our tax rates at the height they are, this kind of argument can be used on almost anything, that the ones who get the most benefit of any tax differential—I don't care what it is—you can always point to those in the highest income tax brackets as geting the most. That is one of the insidious things, I call it, about this high tax progressive rate. In my judgment it really is an unfair argument, because we are trying to look at the economic impact of these things rather than try to benefit this high income tax bracket. I could not care less about benefiting them. I do care deeply about the municipal bond market. I am always interested of course in seeing other alternatives. If there were another alternative which was sound of providing a broad market for municipal bonds, that is something else. But I don't think it is quite cricket to come in and attack the municipal bond market as it is in the guise that what you are doing is attacking the benefits that go to rich people. That gets our minds off the issue.

I regret to say that is what is being done constantly on these economic matters, by talking about what happens to rich people under this very high progressive tax structure, and our minds become distracted from the economic issues that we are really concerned with. I think you will agree that our real concern here is, are we going to be able to maintain the financial position of State and local governments.

I think you must agree that such proposal as this really would deteriorate the financial position of the State and municipal governments, would it not?

Dr. HELLER. The proposal to withdraw the tax exemption? It would depend entirely, of course, on what it was coupled with.

Representative CURTIS. Just for hypothetical purposes, just to remove it, which is all I am addressing myself to now, if you could provide a market in lieu thereof. Right now, just the removal would deteriorate the financial positions of State and local governments, wouldn't you agree?

Dr. HELLER. Essentially what I was saying, Congressman Curtis, was that, according to these data if the exemption were removed about one-fifth of the total tax increase would come down as a burden on State and local borrowing. To that extent the interest rates would rise. The four-fifths does not apply just to wealthy people. It applies to the aggregate. I was not singling out wealthy persons in this respect. Four-fifths would appear as a reduction in the tax benefits to all income-tax payers.

Representative CURTIS. So we are talking about what is the impact of the one-fifth. Let us take these figures as accurate, and say all right, it is one-fifth. But what will that one-fifth do? I have asked what I thought was really an obvious question. It would very dangerously affect, I would think, the financial position of State and local governments. I have asked you the question and I still have not got an answer.

Dr. HELLER. No, I have said that it would increase their borrowing costs somewhat unless it were coupled with some other method for the Federal Government to share in these borrowing costs by some other means than through tax exemption. May I come back for a moment to your earlier comment about the general position?

The CHAIRMAN. May I elaborate on that? I know I am taking up too much time, and I apologize to the members of the committee. I shall cease and desist after this, but on Mr. Curtis' statement, we must have a market. Back in the RFC days, the RFC purchased these bonds when they did not find a ready market at a good price. I think the interest rate was about 3 percent at that time. Yet the RFC did not lose money, it made money on these bonds. It was an enormous sum.

I think there should be a market. In the event private investors do not provide a market, then the Federal Government should provide a market for these bonds.

I remember a midwestern city recently issued about $50 million of bonds, and it was pointed out at the time that the interest rate was so high that a person fortunate enough to have a million dollars could buy a million dollars worth of those bonds, and if that was all the property he owned, he would not have to deal with the Internal Revenue Service. He would not have to make any report of any kind on the bonds, interest, or anything else, because they were not taxable, yet he would have an income of about $5,000 a month. I am not trying to incite any feeling against people who have a million dollars. I am just giving that as an illustration of what can be done as compared to investments in other lines of business, where the investors have to share in the responsibilities of the community, the State, and Nation. But in this case they do not share.

Go right ahead, Dr. Heller.

Dr. HELLER. I was just going to comment briefly on the earlier observation that Congressman Curtis made about our mention of the deteriorating position of the State and local government. This mention was made, of course, in the context of the 1961 outlook. In effect we were trying to assess whether the State and local governments would in the coming year increase their expenditures by the 8 percent per year compounded increase, after price increases have been netted out, that they have been experiencing in previous years.

We certainly welcome the opportunity afforded by your question to expand on this point. We do not pretend that our answer says all that there is to say by any means. It is a complex subject. I think a good deal more evidence can be adduced that the State and local position has come under increasing pressure. I am sure as Mr. Curtis mentioned that I am influenced in this judgment by my own experience in Minnesota in the past 6 years, where, as compared with 1954–55, the 1960–61 position is a much more financially oppressive one.

Representative CURTIS. In other words, what you are saying is that for 1961 you think that we probably will not have that average 8-percent increase we have been having in this area?

Dr. HELLER. We were questioning whether there might not come a time in the reasonably near future, not necessarily 1961, in which the hard-pressed financial position would cut down the increase at the State and local level. The projections now suggest that this will not be the case for 1961 itself.

Representative CURTIS. I certainly think this is worthy of real study because on the floor of the House we have already had this as the base of the arguments why the Federal Government must move into these areas, and we will have it very shortly in the school construction and other things. I think a little more light and less heat will be helpful in the Congress.

The CHAIRMAN. Have you finished your comments on the question?

Dr. HELLER. Yes. On the State and local government question, I was going to go on to make a comment on the material on page 15 which relates to Mr. Curtis' question No. 8, the long question. Rather than repeating it, I would like to pick out one point for a bit of additional comment.

It has to do with the question you raised, Mr. Curtis, about the shift from goods to services. It led us to take a rather interesting exploration, in greater detail than we had earlier, of the relative shift in the pattern of production and consumption. Perhaps I should read that whole paragraph on page 15:

> It is often claimed that, as an industrial economy develops, there is a shift from manufacturing to service and distribution. The facts in the United States since 1929 are far from clear. It is certain that during that period the part of the population engaged in agriculture declined sharply and the part engaged in Government and Government enterprises increased sharply. Eliminating these two sectors from the total, one can roughly divide the remaining industries into a commodity-producing group and a distribution and service group. Between 1929 and 1953 the first group increased while the second decreased (in terms of fraction of persons engaged), and between 1953 and 1959 the reverse was true. Between 1929 and 1959 there is almost no difference in the distribution of the working population between the two groups. The shift to services since 1953 may represent a new longrun trend, or it may simply reflect the development of general slack in the economy.

I want to add that we ourselves were somewhat surprised to find that there was no shift from 1929 to 1953. At the same time, we don't deny that the shift to additional Government services is part and parcel of an overall shift to emphasis on services as the economy expands.

Representative CURTIS. This is a really interesting study here. I think you undoubtedly agree that here is an area where we need to do a little more watching. Incidentally, part of this comes in the manufacturing sector where it looks like we are shifting from the blue-collar worker to the white collar. I don't know what it means, but it does look like that has been occurring. I would not know the dates there, but I suspect it might conform to the 1953–59. This might all get back to my basic thesis, that this proves that the economy was quite dynamic from 1953 to 1959, rather than the conclusions that you suggest, that there is a general slack. But that can be developed later.

Dr. HELLER. Mr. Chairman, that is all the amplifying comments we have.

The CHAIRMAN. Congressman Curtis and I probably have exhausted our 10 minutes each. I will call on Senator Proxmire.

Senator PROXMIRE. Before I got into something else, I would like to follow up the question that Congressman Curtis asked, and you answered, with regard to State and local governments.

In the first place, I am very sympathetic with the viewpoint that I feel Congressman Curtis represents, that we should do all we can to permit and encourage local and State governments to do as much of the public sector work as can be done for many, many reasons. I think that you very well state the difficult fiscal problem for the State and local governments. I wondered if any consideration has been given to income-tax sharing—Federal income-tax sharing. It has been tried within a number of States—sharing with local communities. It has in our State for many, many years with great success. It is one way of providing the funds on a progressive tax basis, and permitting administration and responsibility and so forth to be local. Do you have any views on this?

Dr. HELLER. Senator, one of the personal research projects that I had to terminate when I came to Washington in January was an investigation of precisely this matter, that is, the possibility of tax sharing, tax credits, grants-in-aid and a comparison of these alternative methods. This does not happen to fall very directly in the jurisdiction of the Council and I cannot say that we are pursuing this work actively within the Council. I am sure it is something that is being thought about, and there is a project at the Brookings Institution that is explicitly directing itself to this subject right now.

Senator PROXMIRE. It is very interesting to hear about that Brookings study. I feel, for example, on the Federal aid to education, that this is one way of reducing to a minimum the threat which many of us feel of Federal domination and control of education, while at the same time providing the kind of financial assistance which even conservative and limited Government people such as Senator Taft recognize as essential.

I would like to go on and ask this. In your answers you mention $50 billion as the increment in gross national product that would be necessary to close the present unemployment gap. Does this assume that we would have 4 percent unemployed if the GNP could be increased by $50 billion?

Dr. HELLER. Yes. These two figures are consistent with one another. That is to say, that in calculating the potential that led to the $50 billion gap figure, we used, as indeed the committee staff had done earlier, the 4 percent unemployment rate as the basis for calculation.

Senator PROXMIRE. Secretary of Labor Goldberg, it seems to me, has been reported to have a different figure of $70 billion. That would apply to a 3 percent unemployment, is that correct?

Dr. HELLER. It sounds reasonably consistent with the $50 billion at 4 percent. I don't have the exact translation but it sounds about consistent.

Senator PROXMIRE. Incidentally, you are talking about the increase in constant dollars, I presume.

Dr. HELLER. Yes.

Senator PROXMIRE. I have in front of me the economic indicators for March, and on page 1 it shows that since 1949 the gross national product has not increased absolutely in any year despite all the massive influence of Korean war spending and 1954 tax act stimulation and so forth, by more than $33 billion in any year. On a percentage basis, as I calculate it very quickly, it has not increased by more than about 8 percent in any year. Perhaps my figures are not precisely correct, but that is a rapid calculation. In view of the fact that a $50 billion increase would be approximately a 10 percent increase in the gross national product, it would greatly exceed any increase we had in the Korean war period or the great stimulus of the 1954 tax act. In view of this can you see anything at all in the picture at the present time that would suggest that we could conceivably get this $50 billion increase in gross national product and reduce unemployment to a 4 percent level during the coming 12 months?

Dr. HELLER. Senator, we have suggested that is is very unlikely that this $50 billion gap can be closed that fast. This has been one of our concerns about longer range policy.

Senator PROXMIRE. If it is not going to increase that fast in the next 12 months, we will need a much greater increase than $50 billion in gross national product in 2 years if we are going to close the gap. Would we need a $80 billion increase or what?

Dr. HELLER. No. We have suggested that the potential of the economy at this 4 percent unemployment level increases by about $17 billion a year. In other words, you need about a $17 billion increase in the gross national product, in effect, merely to stand still, that is, merely to absorb the net additions to the labor force.

Senator PROXMIRE. Doesn't that figure contradict the one we had earlier this year by Dr. Clague who calculated, as I recall, $20 or $25 billion in order to maintain the present level of employment and not slip below it? Your figure at any rate is $17 billion constant dollars.

Dr. HELLER. This is a deflated or constant dollar figure. If you took without the deflator—in other words, if you allowed for approximately a 1-percent increase in prices—you would come out with about his figure.

Senator PROXMIRE. Frankly, looking at this record, as I say, it includes the Korean war and it includes very massive stepups since 1949 in defense spending, by the Federal Government, it includes the 1954 Revenue Act which was certainly stimulating in many ways, I am pessimistic. In spite of all of this past stimulation we have an average increase that doesn't come close to providing $50 billion, or if you take the average of $67 billion over 2 years, or a $33 billion increase in each year.

I call your attention to an article just this morning in the New York Times which I think went into detail on what is happening in steel. Let me quote three brief sentences from it, and ask for your comment in the light of what confronts us. It states that the bottom of the steel recession has been reached, but there was no sign last week that a sharp uptrend was imminent. Rather it was said there was a slow rise in order flow and output. In some cases there maye be a drop in some weeks. However, most steel observers agree that the worst is over. One of the most significant factors has been the small improvement in demand for more steel production. Demand for sheets and tubes products has been growing but the level for structural shows little change from a month ago. The biggest worry is the problem of steel demand after seasonal factors are eliminated. Some steel mills wonder what the flat roll picture will look like after the auto companies decrease their ordering in advance of getting ready for the new models this summer. I had a chance to look at Mr. Hitch's statement for this afternoon and I notice that the last quarter of fiscal 1961 that is the current quarter, April, May, June, is when obligations of the Defense Department are going to reach their peak and when the greatest impact on the economy of defense spending is going to reach its maximum. In the light of that, doesn't it seem that we have some real long term worries ahead in view of the fact that the bellwether of the American industry, steel, looks toward a little improvement, but a very modest one?

Dr. HELLER. We have suggested earlier that this is a very stubborn problem that will not be solved overnight. Your point underscores that appraisal of the situation.

The CHAIRMAN. Senator Bush.

Senator BUSH. Mr. Chairman, I would like to go to your statement of questions and answers where you talk about the anticipated deficit financing a little bit. I would like to draw you out on that.

When Mr. Bell was down here a week or two ago, in response to our questions he indicated that in addition to the $2.3 billion deficit forecast on the homefront, there was a billion dollars' additional likely to occur to the trust fund deficit. So you would have a total cash deficit of $3.3 billion, to which should be added $700 million of the increased defense expenditures, this applying to the 1962 budget.

So you come up with a total projected deficit at that time of about $4 billion as a cash deficit. We are told, I believe by the Council, and others representing this administration, that when activity is at a high level and national income is at a high level, that this is the time to run a surplus. When the situation is deteriorating this is the time to accept a deficit. Not enthusiastically, but sometimes we have to do that. We have seen times when we have to do it, and there would be no argument about it. But the evidence seems to be piling up that we are on an upgrade here, if very gradually. At least we seem to be reaching the bottom. You people told us the last time you were down that you are hopeful that things will get better, and that 1962 should be quite a lot better, and so on. Yet we go ahead anticipating and planning for a cash deficit in the 1962 year of $4 billion.

There seems to be some fear that it may go up. It seems to me that with the gross national product and the national income at record high levels last year, and forecast at higher levels this year, that this is not a good background against which to plan a deficit. You take issue with the fact that deficit financing is necessarily inflationary. I don't see how you can get away from the fact that deficit financing that we have done over a period of the last 22 or 23 years has had a depressing effect on the value of the dollar. What we have done is to a large extent finance that through the banking system which in effect has created an increase in the money supply without changing the supply of goods.

To my mind that makes for inflation. In fact, I don't see how you can get away from it unless you have a lot of other deflationary factors working against it. In part of your answer on the middle of page 31, you say in the present situation of the American economy, if one believes that expansion generated by budget deficits would result in unacceptable risks of inflation and external byproducts, he should logically favor measures that discourage forces of expansion in the private economy as well.

I don't see how that follows at all, because the inflationary impact of deficit financing is really monetary. Where we have had balanced budgets over the history of this country, it has lent for stability and confidence. As in the twenties, one of the greatest periods of expansion we ever had, we were having running surpluses in the face of very active and very profitable business. So I don't see how that statement holds, that we should logically favor measures to discourage forces of expansion in the private economy. Can you explain that to me?

Mr. HELLER. May I take your points up seriatim? First of all, I would agree entirely that we can distinguish in effect between constructive and destructive deficits, whether they be governmental or private. The constructive deficits, as your statement suggested, occur at a time when there is large-scale unemployment of manpower and materials and machines and plants, widespread excess capacity, etc. Under such slack conditions, the deficits express themselves not in higher prices, but in an increase in production and employment and income. Indeed, that is the situation we find ourselves in today when we are about 10 percent, or about $50 billion, below our readily reachable potential.

In a situation like this, these deficits will tend to be translated into higher production and employment and income, that is, they are economically constructive. I will comment in a moment on destructive deficit.

Secondly, over the longer run, whereas it is surely true that the World War II deficits increased the money supply faster than the level of production, this has not been true in the fifties. The money supply has not been outstripping the growth of gross national product.

Thirdly, as to the relationship between public deficits and price stability and public surpluses and price stability, I would like to make two or three additional comments.

Whether the deficit financing comes from a business which is borrowing well in excess of its current expenditures, or from a household that is borrowing via installment debt, or, alternatively, whether it is the Government borrowing in excess of its tax revenues, makes no essential difference to its impact on the economy. Each of these has a stimulating effect on the economy. Part of our point here is that when the economy reaches the point where the total level of demand exceeds the available supply of goods and services at constant prices, one needs to cut back the Government expansionary activities as well as private expansionary activity. Indeed, that is the concept which calls for Federal surpluses at a time of full employment. For then the deficits become destructive deficits, because they express themselves in higher prices rather than in higher production, employment, and income.

In looking at the historical record of the postwar period, especially during the fifties after the wartime deficit financing, and increase in debt had, so to speak, been worked off, it is very interesting to find that in a period when we had surpluses in the Federal budget—1956 and 1957—they were not enough to offset the deficits in the private sector. We find that although we had surpluses in fiscal 1956 and fiscal 1957, the consumers' price index rose from 114.7 in July 1955 to 120.8 in July 1957. The wholesale price index rose from 110.5 in July 1955 to 118.2 in 1957. Then, as you recall, in the recession of 1958, we ran a $13 billion Federal deficit on a cash basis for fiscal 1959, and from July 1958 to June of 1959 the consumers' price index rose from 123.9 to 124.5, in other words, 0.6 of 1 percent. By January 1960, it had gone up another 0.9 of 1 percent to 125.4. In other words, a much smaller increase occurred in the cost of living in the face of the $13 billion deficit than in the face of those surpluses.

The wholesale price index during that period was almost perfectly steady. July 1958 it was 119.2, June 1959, it was 119.7, 1960 it was 119.3. This suggests that in formulating economic policy, and particularly budgetary policy, one has to interrelate the actions of governmental budgets with the reactions of business and household budgets. Mr. Tobin would like to add a comment on that.

Dr. TOBIN. I would just like to call attention to a distinction which I think you had in mind, Senator Bush, the distinction between the deficit financing and the handling of the debt after we have it. The second part is the question of how much of the debt is monetized, how liquid the debt is, that is the province of the monetary authorities and the Treasury debt management authorities. But there is nothing that compels them to keep the debt in monetary and liquid form if at a future time we should have an inflationary problem, rather than a recovery problem. The fact that we use deficit financing as an aid to recovery does not mean that when the recovery is over, we are stuck with that much of an increase in the supply of money. Very likely the debt won't be financed by monetization anyway, and when the danger of inflation arises, it will be open to the monetary authorities to make the debt less liquid and to demonetize it to the extent that it is necessary to restrict demand at that time.

Senator BUSH. Of course, there have been efforts made to extend the debt and to offer long-term bonds, but the market has not been there. Of course, the debt ceiling which the Congress has kept on—I mean not the debt ceiling, but the interest rate ceiling—was a great mistake. I am hopeful you will advise us to take that off so that the debt can be lengthened. I agree with you that the longer debt financing you can do, the less would be the inflationary effects of deficit financing. But without doing it on the long-term basis, and we don't see yet any possibility of doing very much on the long-term basis, I can't see how we get away from the fact that it will have an inflationary impact that will not be helpful in the whole situation.

If you look at countries all over the world—and you gentlemen probably have much closer than I—and if history of governments that have tumbled because of bad fiscal procedure and bad housekeeping, it has been largely the result of the bad handling of their debts, and handling of long-term problems on a short-term basis, and largely putting the money through the banking system. We have seen that in China, Germany, Argentina. We have seen it everywhere. We see Brazil getting into a lot of trouble now. Apparently they have a strong man down there now who is going to put on the brakes and is going to see an improvement in the orthodox procedures.

I don't want to see the credit of the United States come into question because on this credit depends the security of the entire free world today. This is why I think this is such an important matter. I do feel that this administration has a very, very great responsibility right in this field.

I might say further that I understand they are going to send down shortly some legislation that will tend to have an effect upon the private sector, some legislation respecting depreciation allowances or tax credit. At the same time, I understand they are going to send down something in the nature of a package deal so that what they give out with the one hand, they will take back with the other. Like the fruit vendor says, what you make on the peanuts you lose on the banana. I don't want to see us in that position.

I think what is lacking here, and what we need to go ahead on, to use some of the President's own language, is a little bit more incentive to the private sector, and an attitude of trust. If we are going to live in a free-enterprise system, let us make it free and give it all the help and confidence that we can to go ahead and spend the people's savings in new productive facilities and expansion and so forth, and not discourage the private sector by assuming so much of the national income for Government operations.

That is the general point that I wanted to make here. Have you any further comment on it?

Dr. HELLER. I will comment only to the extent of saying that the objective which you have just stated is one that is shared by the administration. Indeed, in proposing tax incentives, and offsetting revenues to finance those incentives, the administration has noted that it is trying to do precisely what you are suggesting, namely, to stimulate the private sector to modernize and expand plant and equipment.

In seeking offsetting revenues, it is trying to find those tax preferences or tax concessions which represent a loss of tax revenue and tax equity without any counterbalancing stimulating effect. This is the kind of an approach that the administration has been taking in formulating a tax program.

Senator BUSH. My time is up and I will yield.

The CHAIRMAN. Mrs. Griffiths.

Representative GRIFFITHS. How many times in the last 8 years has the demand for goods and services exceeded the supply?

Dr. HELLER. I wonder, in response to your question, if it might not be a good idea to refer, if I can readily do so, to the chart 4 in our original testimony. This is a relative question, of course. Essentially you are asking, I believe, the question of how often demand has exceeded supply at present prices, and as a consequence prices have risen in order to equate demand and supply.

Representative GRIFFITHS. Yes, I am.

Dr. HELLER. That is not a question that permits of an absolute answer. In the period 1953–61, we have had periods of relative price stability between about 1951 and 1955. Then prices rose at a rather rapid rate by the standards of the preceding 4 years, for 2 or 3 years, and then again the rate of acceleration of prices slowed down considerably. In other words, we would have to look at the indirect evidence since we have no direct evidence by which we could answer that question.

Dr. TOBIN. On the chart, there are only two periods where, on our calculation of potential, we were pressing above the potential by trying to make actual output higher than the longrun trend at 4 percent unemployment.

Dr. HELLER. Those two periods were in the first half of 1953, and very briefly, around the third and fourth quarters of 1955.

Representative GRIFFITHS. Isn't it true that as the demand decreased, the prices did not decrease, but in general rose?

Dr. HELLER. Except for this one period of relative price stability of about 4 years in the Consumer Price Index, and about 1 year of price stability 12 months beyond the recession of 1958, there has been an upward drift in prices even when, as shown in this chart, the actual level of output was considerably below the potential level of output.

Representative GRIFFITHS. How do you explain it?

Dr. HELLER. This is a combination of the increase in prices of services, in particular, over this period, and factors associated with the cost-push problem in our economy.

Representative GRIFFITHS. Thank you.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. First Mr. Chairman, I want to say that I have now had an opportunity of going over these answers, and I want to thank the Council for a very fine job. Let me say that I think it is beginning to pinpoint the issues.

One thing that we are sure of is that the debate is moving forward. I am going to enjoy very much making my additional comments on these answers after I have had a chance of studying them fully. This is high-caliber work, gentlemen, in my judgment, for what it is worth, and I want to commend you for it.

Dr. HELLER. Thank you.

Representative CURTIS. Just picking up this one point that Senator Bush was discussing, the impact of deficit financing in a period when it appears that our economy measured by GNP is going to be setting new records. I guess we can call them prosperous times. One of the problems is, of course, that if we cannot market our bonds at the Federal level, then we do have to monetize them. The key to the point is how much the market will absorb. One of our problems in early 1962, aside from having to market, as near as I can figure if the Kennedy program goes through, of about $8 million of additional bonds—some of them coming because we are going to have the free market of the social security fund because we are going to cut back there a little bit for a while—we have around $30 billion that we have to refund in early 1962. We are going to have an additional $8 billion on top of that. That is why I suggest we are creating—and I tried to word it carefully—forces that would create inflationary pressures that cannot be controlled under the present state of the economy.

I do agree that a deficit does not necessarily have to result in inflation. It simply is a pressure that can or cannot be controlled. So I was directing attention to whether or not this situation was not going to create those pressures.

Above all, and I think something that to me is more disturbing, is what will be the impact of 2 years of deficit financing in 2 prosperous years in respect to our balance of payments abroad and the psychological effect, and a great psychological—this fiscal policy will have on the nations abroad.

If you would care to say anything further, I just wanted to follow up Senator Bush's comments on this.

Dr. HELLER. May I call on Mr. Tobin to comment on these questions?

Representative CURTIS. Yes.

Mr. TOBIN. At the moment we have a problem of giving the economy an added stimulus to get to a high enough level of employment and output. Senator Proxmire's questions brought out the fact that we have a long way to get there even though in absolute terms the GNP is high. In that kind of a situation I don't think that we would feel it is appropriate to engage in long-term financing of the Federal debt.

What we need is to get long-term interest rates down in order to stimulate private investment. It may be appropriate at a later time when we have a different economic environment and a problem of restraint of inflation to lengthen the debt and to be restrictive in the monetary sphere in the rate at which the supply of money is allowed to increase.

Representative CURTIS. The shorter the term of bonds the more you get closer to money; is that right?

Mr. TOBIN. Yes; but at the moment we need a monetary stimulus to the economy as well as a fiscal stimulus to the economy. The money supply has not been growing over the last couple of years. We need to have some monetary stimulus. Professor Schumpater, who was one of my teachers, used to say the reason automobiles can go fast is that they have good brakes. I think that is true.

The reason that we can press on the accelerator now when we need to is that we do have the monetary and fiscal tools to combat inflationary pressure at a later stage should that arise.

Representative CURTIS. The thing that worries me is whether or not you are not contemplating brakes, and sometimes I wonder whether this spurt of speed in this way is not so that you can argue that we need the brakes. From what I worry from the economic theories, as I understand them, that you and your school of thinking promote, we then will be presented with the need for Government controls, credit controls, and so forth.

Let me be sure of this. At this time you are not advocating even standby controls, are you?

Mr. TOBIN. The brakes I was referring to are simply the traditional instruments of monetary and fiscal policy.

Representative CURTIS. Some of these traditions have grown up so that maybe people would refer to various controls as traditional. Do you mean to include those when you say "rely on traditional, instruments of monetary and fiscal policy," or do you mean to eliminate them—I hope.

Mr. TOBIN. If you are referring to direct wage and price controls over the economy, that is not what I was advocating.

Representative CURTIS. You are not including them in traditional?

Mr. TOBIN. No, sir.

Representative CURTIS. It has not become traditional yet?

Mr. TOBIN. I am talking about the instruments at the disposal of the Treasury and Federal Reserve and Congress in the realm of tax policy, the budget, monetary policy, and debt management.

Representative CURTIS. I am very happy to have that assurance at this time, although I am afraid that if the other school of thought is correct, we will have inflationary pressures.

Frankly, I don't see how we can avoid it in this picture unless we start knocking out this deficit financing and cutting some of these programs back and trying to live within our budget.

As I analyze what you have been saying and as I have tried to analyze the fiscal theory of this administration, it is that you are going to gain your additional revenues from economic growth that you see. You have abandoned the old theory now. It used to be that we recoup what we had overspent in the periods of recession in periods of prosperity.

Of course, we will have, I guess we can call it, in 1961 and 1962 an anticipated period of prosperity. There is no attempt whatsoever to recoup for the deficits of the recessionary periods. So we are going to the new philosophy of growth. That leads me back to question No. 10 and this whole concept that you have advanced of potential levels of output versus actual levels. That is based upon the model contained in the Economic Council's original testimony. I think the model is quite interesting, but as far as having any relation to actuality I suggest that it hasn't. I say that for this reason.

Maybe I better get a definition in here first. You refer to unemployment at any time on a scale that now exists in the United States as wasted economic potential. In one sense of the word "waste," that is true; just as in an industrial process, if you take a bar of steel that you are going to machine and in the process of machining you have waste metal.

But in the broader sense of the term, or rather let us say this: in a nicer sense of the term "waste," that is hardly economic waste, because any process is going to create that kind of waste.

Let me be sure that we are using the same terms. How are you using the term "waste" in this sense? Perhaps unnecessary waste or necessary waste. You recognize what I am referring to in the term "waste" as the necessary waste? You would accept that as a fair definition?

Dr. HELLER. Yes.

Representative CURTIS. So in your reference you are talking about unnecessary waste; is that right?

Dr. HELLER. That is to say we are talking about a loss of production, a loss of employment, and a loss of income that need not have been incurred.

Representative CURTIS. That is what I want to get to. The whole theory of the unemployment insurance program is that in a dynamic economy we are going to have people go out of jobs and then have to relearn new skills, retrain and so forth and come into new jobs. Would you call the process while a person is on unemployment insurance as part of that waste?

Dr. HELLER. That is to say there is a certain amount of necessary unemployment, in the sense of frictional and structural unemployment, that is difficult to dissolve. This is what we built into our 4 percent allowance. We don't mean to say the 4-percent unemployment rate is a goal but a figure which we have accepted as an intermediate basis for calculation and which is, indeed, a very modest target of the potential of the economy.

By that modest target we arrive at a $50 million gap.

Representative CURTIS. In your model, when you talk actual and potential then you are allowing for that 4 percent?

Dr. HELLER. Yes; indeed we are.

Representative CURTIS. So all you are talking about as far as the labor force is concerned is that part which is over and above the unemployment that we are going to have if we grow and continue to advance and demand new skills and drop out the need for old skills?

Dr. HELLER. We are talking about the reduction of the present seasonally corrected 6.9 percent rate of unemployment to this intermediate goal of 4 percent.

Representative CURTIS. Why isn't a better figure of unemployment the people on unemployment insurance? Today the figures are something like 30 percent of the labor force is women. This is really a post-World War II phenomenon of women coming in to the labor market to this extent. Our figures for the 1930's in the way we compute unemployment would never have regarded the women who were not in the labor force as wasted economic potential.

Today, though, with the changes, we call it wasted economic potential.

Dr. HELLER. The figures for the labor force and for unemployment count only those women who are in the labor force and who are actively seeking jobs.

Representative CURTIS. I know, but that is a subjective test. We are all familiar with how we check unemployment. That is why I thought maybe the people who are on unemployment insurance or who have been on it and have exceeded the amount of coverage would be a more accurate test in trying to figure out this model. I see my time is about up and I will come back.

The next point I was going to make was in reference to the area of excess capacity. Because in there, too, just as we advance technologically and make obsolete a lot of skills and the need for unskilled people, so we create a lot of obsolescence in our capital plan which I am afraid has been included in here as excess capacity.

Dr. HELLER. Just one other comment on the statistics, if I may. I would hate to think that, as the great additions to the labor force among our youth now come onto the market, we would not count them as part of our unemployment problem, just because they have no right to unemployment compensation when they first enter the labor force.

Representative CURTIS. I think you are making a good point; yes. I agree with that.

Dr. HELLER. Of course, in the case of women entering the labor market, many of them are doing so under the stress of family tragedy, and so forth.

Representative CURTIS. That is a theory. I am willing to test the theory but I am not willing to base conclusions on it until it is tested.

Representative GRIFFITHS. I trust the gentleman from Missouri is not willing to count the women out because they did not work in 1900.

Representative CURTIS. No. The women in the labor force are a very interesting phenomenon. Something we are wondering is if it is going to increase or should we increase that. I well remember when they first came in we had to change our Missouri laws in order to comply with actual working conditions that the employment of women required because women in the factories were so unusual in those days.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Dr. Heller, I am very glad that you emphasize the necessity for lower longtime interest rates in order to stimulate homebuilding and small business. I would like to address your attention, if I may, to page 33 of your statement of March 6, which shows the comparative movement of longtime interest rates in previous business cycles. If you take the yield on triple A bonds, corporate, you may find from your table that the decrease in the 1953–54 period was from 3.42 to 2.85, a decrease of fifty-seven one-hundredths percent in absolute terms, and have approximately one-sixth in relative terms.

In 1957–58 it was a fall from 4.14 to 3.55 or a decrease of fifty-nine one-hundredths percent absolute terms, or about one-seventh. In the present cycle it is a decrease from 4.61, and the figure in economic indicators for March 18, was 4.2, or a fall of four-tenths of 1 percent, in absolute terms approximately one-twelfth. In other words, the fall in interest rates has gone much more sluggish in this recession than previously. Is that your judgment?

Dr. HELLER. That is correct, and a source of very considerable concern.

Senator DOUGLAS. How do you account for this slowness of the longtime interest rate to move down?

Dr. HELLER. May I ask Mr. Tobin to comment on that?

Senator DOUGLAS. Yes.

Dr. TOBIN. I think the main accounting for it is the constraint which the international situation has put on the easing of monetary policy. The anchor to the whole interest-rate structure, the discount rate of the Federal Reserve, has been kept at 3 percent, whereas in the 1957–58 recession it was lowered to 1.75 percent. Holding the discount rate up and and also holding the short-term bill rate up has had effects throughout the spectrum of maturities and made difficult for interest rates to fall to the extent that they did in previous recessions when short rates were permitted to fall much farther or were pushed much farther down.

Senator DOUGLAS. A fall in the longtime interest rate is essential and to get a greater rate of stimulation in small business and homebuilding. Is it the import of your statement that we can not get an appreciable fall until or unless we are removed from the constraints of the international balance of payments?

Dr. TOBIN. Not necessarily. The Federal Reserve on February 20 announced a new policy of buying also in the long-term markets, with the objective of lowering those rates relative to the short rates. We would hope that those efforts will be successful and will result in a lowering of general long-term rates, and they can be supplemented, as they have been, by specific measures in the housing field and in the small business field to lower particular rates where the Government has tools which are more direct than the general tools of monetary policy.

Senator DOUGLAS. Mr. Tobin, as you may know, I have been advocating for several years that the Federal Reserve should expand the money supply at approximately the rate of 3 percent a year, that it should give up its bills-only policy, and that it should expand the money supply not by lowering the reserve ratios but by open market operations. In its open market operations, as I have said, it should expand the supply by purchasing primarily long-term securities. If you take a 3-percent growth in the money supply on a $20 billion rough member bank reserve figure, you come to around $600 million a year of long-term securities which could be purchased by the Reserve.

Do you have any estimate as to how much of a reduction in the interest rate or the yield, rather, this would cause?

Dr. TOBIN. I am afraid not, Senator Douglas, because what we really don't know until this experiment has been tried and studied is how much substitutability and fluidity there is between the short and long markets. If it is maintained, as some observers in the markets believe, that there is very great fluidity, then the money put into the long end will just come back to the short end, and it won't be possible to do this twisting operation which the Federal Reserve has now undertaken to try. If on the other hand they are not such good substitutes, the Fed will be able to push down the long rates a good bit while keeping the short rates up.

Senator DOUGLAS. You are making a very guarded reply. Let me ask you, Do you approve of these three features of Federal Reserve policy that I have been advocating? First, that the money supply should expand at approximately the rate of 3 percent a year. Second, that this should be done through open market operations rather than lowering reserve ratios. Third, that it should be done primarily by purchase of long-term securities rather than bills only.

Dr. TOBIN. I personally favored the abandonment of bills only also, Senator, and I have felt that we could have had more expansionary monetary policy over the past few years and that this expansion should be carried out by open market operations rather than by the lowering of reserve requirements. Those are personal views, in which I agreed with your position. At the same time, I don't favor any mechanical rules about the degree to which the money supply ought to be expanded in any given year.

Senator DOUGLAS. I simply meant a sort of longtime average of 3 percent. Of course, you could vary from year to year.

Dr. TOBIN. I also think that whether you use purchases of bills in short markets or purchases of bonds in long markets should be quite flexible and depend on the situation at the time. There is no reason why the monetary authorities should not have all these tools at their command so that they can use the tools that are best adapted to the situation.

Senator DOUGLAS. In view of the fact that the long-term rate is much more sluggish than the short-term rate, and in view of the fact that we want to reduce the long-term rate, would it not be well for the reserve to concentrate primarily in long-term securities rather than short-term bills?

Dr. TOBIN. At this juncture, but that is because of the particular problems of the international situation. There may be lots of times in which all the objectives of the Federal Reserve can be achieved by operating solely in the short term markets. Then when that can be done, there are advantages in doing so. But I think they should always feel free to use the operations in the long-term markets when objectives require.

Senator DOUGLAS. The Reserve in the past has gone on the assumption that the basic rate of interest was the short-term rate and if you affected the short-term rate you affected all other rates.

Do you think this is as true as the opposite contention that it is the long-term rate which tends to be the basic rate upon which other interest rates are built, particularly in the private sector?

Dr. TOBIN. The Government long-term rate no doubt is more closely connected with the private long-term rates than is the Government short-term rate.

Senator DOUGLAS. That is the point.

Dr. TOBIN. At the same time there is quite a close connection between the Government short-term rate and the Government long-term rate. That makes it possible for the Federal Reserve to enter the situation at any one of a number of places.

Senator DOUGLAS. It is possible but which entrance should it take at this juncture? There are a number of doors it can enter. Which is the better door?

Dr. TOBIN. At this juncture there is no question they have to enter at the long-term end because of the international situation.

Senator DOUGLAS. Do you think the Federal Reserve Board has seen this situation with great foresight or has it approached it very reluctantly, slowly and with delay?

Dr. TOBIN. I believe their statement of February 20 adopts this diagnosis of the situation.

Senator DOUGLAS. Would it have been better if it had done this 6-months earlier?

Dr. TOBIN. They made slight moves in this direction 6 months earlier by moving from bills to bonds which were in the neighborhood of a year to 15 months—15 months before maturity. What they have done since is a sort of extension of that, which has gone first out to 5 and 10 years and then now they are engaged in operations in maturities over 10 years. I don't know how much speed of evolution one should hope for.

Senator DOUGLAS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. I would like to pursue, Dr. Heller, my previous questioning. I think I had arrived at a point where at least I felt that you agreed with me, that we have a long, tough road to travel in order to provide even a minimum of 4 percent unemployment in the economy. Now my question is, What can we do about it? In the first place, there is no question that we all agree that optimistic encouraging talk by the President and by other officials is a helpful thing. But at the same time, I find this limits us in a sense in how soberly and seriously and realistically we can actually appraise the situation that confronts us. I think this is one of those problems that we all have in our mind that acts as an unfortunate inhibitor.

You have made a case for compensatory fiscal policy to us. At least in the current period you can argue for a relatively modest deficit. But I am inclined to sympathize with those who criticize this viewpoint on the grounds that this is a long-range problem and not one that we can expect to solve in a few months. Therefore, I am inclined to think that this won't be acceptable to Congress. It may be acceptable to the President, it may be acceptable to you. But I am inclined to feel that we cannot expect to meet an unemployment situation which we can predict is going to be certainly more than 12 months, and in my judgment can easily be 2 or 3 years, by projecting deeper and deeper deficits. I think it is fiscally irresponsible. I just can't see that this is the way to solve the problem.

The second alternative, the one that has been discussed just now by Senator Douglas, is the monetary approach, and I think that our approach here is limited by what you have already said—the international situation. We would like to reduce interest rates and I think we can make a good case for pushing them down to where they were in 1953–54. The table to which Senator Douglas referred not only indicates that interest rates have been sluggish, but that the present interest rates of 1959–61 as compared with the interest rates of 1953–54 are a great deal higher. They are not only higher for corporate bonds and Government bonds, but they are decisively higher for the FHA home mortgages. Certainly this is a big factor in the discouraging of homebuilding.

Once again, however, there is a difficult problem because the Federal Reserve is in charge of this and not the President. It is a difficult problem because there is considerable opposition by those who are in power, the monetary authorities, to very sharp and continuous reduction in interest rates.

So I am wondering where this leads us. It seems to me fiscal policy runs up against a very realistic obstacle in the Congress, which I sympathize with. Monetary policy runs into an equally realistic obstacle and the Federal Reserve has more to say about that and has indicated greater reluctance in going very far.

Where do we go? The most current popular discussion is depreciation incentives. I would like to ask your views on increased depreciation allowances provisions in the law to enable people to write off their equipment and purchase more rapidly and thereby provide incentive for increasing capital spending by business.

Dr. HELLER. Senator, as you know, a Presidential message will be forthcoming on this subject in a few days. It would be premature to speak about anything but the general approach as I did in response to a previous question to this matter of business incentives.

If I may, however, I should like to comment on the earlier parts of your question and observations a moment ago. You commented that we should not be projecting deeper and deeper deficits as a means of approaching the problem of recovery. I am not quite sure what you have in mind, but perhaps the suggestion is that there is a projection of more than a $4 billion cash deficit for years after the fiscal year 1962, which is the current projection for 1962. We have made the point repeatedly that we will be achieving balanced budgets even before our economy recovers all the way to full employment. Indeed, in the answer to question 18 put to us by Congressman Curtis on page 30, we have noted that a balanced budget—this is now the administrative budget—would be achieved for the calendar year 1961 at an average gross national product for the year of $526 billion, with a prospective unemployment rate of nearly 6 percent.

In speaking to the National Press Club the other day, I used a figure of 5.2 percent which was derived from an historical average from the past few years. At the moment, at a prospective unemployment rate of 6 percent, that is, at a level of gross national product that is consonant with that unemployment rate——

Senator PROXMIRE. Let me say that I agree with the realism of that situation. Think what you are saying. We are going to have a balanced budget with unemployment of 6 percent. This means that the contribution of strictly fiscal policy to improving unemployment of 6 percent or less will be zero; is that correct? With unemployment at 6 percent fiscal policy will be neutralized. It will not contribute to putting it lower.

Dr. HELLER. At current levels of Federal expenditure, the budget would balance at 6 percent unemployment. Some expenditure increases are programed and they are part and parcel of the fiscal policy program for economic recovery.

Coming next to the international situation, I think it is fair to say that it is less of a constraint on both fiscal and monetary policy than it seemed to be, or actually was, a few months ago. Part of the difficulty on the fiscal front was that the $12 or $13 billion deficit of 1958 was fresh in our memory. There was a fear that this might be the kind of deficit we were facing again in 1961 and 1962. There has certainly been a good deal of reassurance that by these recent historical standards the deficit would be in the range of $3 or $4 billion rather than three times that amount. More and more observers are raising the question, not whether the deficit is too large but whether the deficit is too small in terms of the restoration of the economy to its full potential. This question is being raised, we are told, increasingly in European financial centers.

Senator PROXMIRE. May I interrupt to ask you—you mean that in European financial centers they are saying that the Federal deficit of the United States is too small?

Dr. HELLER. There has been a question whether the deficit was large enough to do its share of the job of promoting economic recovery. We have had this reported from a number of observers who have recently been in Europe. This is quite the reverse of the impression that was given a few months ago.

Coming to the other part of it, namely, the balance of payments situation, that constraint on domestic policy is a good deal less powerful than it was a few months ago when we were in the grip of a very large gold outflow. It at least raises the question whether the structure of interest rates, for example, cannot be moved down a notch without as great a fear of gold outflow.

Senator PROXMIRE. You say that in some leading financial centers, the experts feel our deficit is too small. You would agree—or perhaps you would not agree—that there has been little sentiment expressed in Congress on the part of anyone to my knowledge—and we would have more to say about that than perhaps anybody else, although the President would have the most to say—expressing the fear that the deficit is too small.

Have you heard any Congressman or any Senator express that in any way, shape, or form?

Dr. HELLER. I think your initial statement was a fair statement.

Senator PROXMIRE. So this is a tough, realistic obstacle to solving this problem by fiscal policy. You say there is somewhat less restraint with regard to monetary policy on the ground that the international situation has improved. We still have, however, in my judgment the direct disagreement between yourself and Chairman Martin of the Federal Reserve who disagreed with Mr. Tobin's analysis of structural unemployment and seemed to leave the impression with me that he would feel that we should not continue to ease money and increase the supply of money at a level at which unemployment would be perhaps well above 4 percent. At any rate, he took a less expansionary position than you did. Therefore, we run into the problem of monetary policy because he has a great deal to say about monetary policy—more than any other man. Of course, his agency is going to make the crucial decision, not the President; therefore, we move down into this depreciation incentive level. My time is about up and I will come back to that.

The CHAIRMAN. Senator Bush.

Senator BUSH. Dr. Heller, I would appreciate it if you would send to the committee at your convenience some evidence of this European point of view that you have referred to that indicates that they don't think our prospective deficits are bing enough to cope with our domestic situation and problems.

Dr. HELLER. Senator, may I say that just as the expression of the opposite view, which was the greater fear of the deficits, was difficult to document because it came in personal conversations and reports from people who had been overseas, this view also is difficult to document. I am talking about expressions of opinion that have been given to us by people who are in touch with these matters.

Senator BUSH. I have not seen such an opinion publicly expressed, have you, in the papers or in the press? Everything else that has happened we have seen some comment about, but this is what I have not seen.

Dr. HELLER. I think that is probably fair to say. I don't recall my clipping service producing these expressions. This view has been increasingly expressed, however, by foreign financial reporters, economists, and officials from abroad who have visited us recently.

Senator BUSH. I am very much interested in that. That is at variance with any information I have on the subject.

Going back to Senator Proxmire's question, and I certainly agree with him that we have in this unemployment problem a very serious thing, and I don't believe we are going to solve it within the next year or two—to our satisfaction, at least. It is one of the things that is one of the most serious things that this administration and this Congress have got to deal with. What is your point about the percentage of unemployment in relation to the desirability of running a surplus?

At the present time you pointed out we have an unemployment factor of upward of 6 or nearly 7 percent, I believe. Is that right?

Dr. HELLER. Yes; seasonally corrected, almost 7 percent.

Senator PROXMIRE. At what point of the unemployment percentage do you think it is appropriate to run a surplus, or do you have any point?

Dr. HELLER. That point will vary according to the inflationary pressures in the economy. These cannot be predicted solely in terms of the unemployment rate. You have to take a reading of the entire range of pressures in the economy.

Senator BUSH. I think that is right. But I do notice a tendency to gear everything else in the way of our spending programs to the fact that we have this unemployment factor. If it works one way, I wonder if it should work the other. I frankly am a little distrustful of the philosophy that you gear everything to the unemployment factor. This does not tend to minimize the importance of them. You say for every $25 billion we reduce the unemployment factor 1 percent, and so forth. I don't believe there is that real relationship there. My only feeling is, and I think it is rather generally held, that what is needed to bring down the unemployment factor is more confidence by the managers of people's savings in this country—people who have the money to invest, the great insurance companies, the pension funds, the individuals, the savings banks, and so forth. What we need to create is a spirit of confidence and this is the great thing. That is why I am so hopeful that this message you spoke of will really provide an increased feeling of confidence and hold out to these controllers of the people's savings an incentive to go ahead and invest and expand so that the unemployment factor can be absorbed.

I have one final question on the matter of interest rates. Is it not still true that this country is the lowest interest rate country in the world with the exception of one or two smaller—much smaller—countries? Is that not true, Dr. Tobin?

Dr. TOBIN. I would not like to answer that without consulting the records. A prominent country which has lower interest rates than the United States is Switzerland, which is supposed to be the model of sound finance.

Senator BUSH. Other countries which have been going ahead aggressively in expanding industrially and so forth, I believe have higher interest rates than we have. I am thinking of Germany, Italy, France, Britain at the present time. Is that not true?

Dr. TOBIN. Germany has had higher interest rates because they have had the opposite economic problem from ourselves, namely, they have been having a boom and a rapid rate of growth.

Senator BUSH. The higher interest rates have not held back their recovery and their tremendous expansion, have they? Are they not really reflections of prosperity rather than a barrier to it? I have reference to higher interest rates.

Dr. TOBIN. The higher interest rates in the countries of Western Europe which have been undergoing both a long-term growth and a cyclical expansion are indeed a reflection of prosperity and of the fact that investment has been exceedingly profitable in those countries in the last few years during this reconstruction and the boom of technology that Europe has been having. But I think the point is that we don't want to have just a reflection. We want to have the reality. We can't have prosperity just by having high interest rates.

If we have prosperity from some other source, then we may get high interest rates, too.

Senator BUSH. You spoke of the Federal Reserve rate being 3 percent at the present time. What is the prime bank rate in New York?

Dr. TOBIN. Four and a half.

Senator BUSH. Is it four and a half now?

Dr. TOBIN. Yes.

Senator BUSH. Is that an unusually large spread for the Federal to be below the prime bank rate?

Dr. TOBIN. No. It is normally below the prime bank rate.

Senator BUSH. One and a half percent?

Dr. TOBIN. The spread from the bill rate is a bit higher. The bill rate is down two and a quarter percent and the calculation of the banks would have to do with the bill rate as against the prime rate.

Senator BUSH. The Federal Reserve normally keeps its discount rate at a level so that the banks don't make too much money by borrowing from the Federal; isn't that true?

Dr. TOBIN. Now they have the levels so that the banks don't make money by borrowing from the Fed to invest in Treasury bills because the Treasury bill rate is below the discount rate. It is the relationship of those two rates which indicates the incentive of the banks to borrow or not to borrow.

Senator BUSH. May we get around a little more in point of what I am thinking about? Do you believe that the Federal Reserve rate of 3 percent today is holding back recovery?

Dr. TOBIN. Yes, I think it is holding back recovery. The question is whether the international situation would permit relaxation of that, or whether we have to accept that constraint. As the international situation improves we can perhaps afford to have somewhat lower short-term interest rates than we have had in recent months.

Senator BUSH. Are there other central bank rates that you know of rather than this 3-percent rate, in any country in the world?

Dr. TOBIN. I am sure the Swiss is.

Senator BUSH. What is the central bank rate there?

Dr. TOBIN. I can't quote it offhand.

Senator BUSH. My impression is—I don't have the figures here, either—that there is not any central bank rate in the world that is lower than the discount rate of the Fed today. You won't either confirm or deny that?

Dr. TOBIN. No; I would not like to without the Federal Reserve bulletin at hand.

Senator BUSH. I will help you out. The latest figure we have for Switzerland is February 1960 so I cannot help you out.

Representative CURTIS. Here we are.

Senator BUSH. It is 2 percent in Switzerland. Otherwise, according to this table, except Honduras, there is not any.

Dr. TOBIN. This is one of our problems. Those other central bank rates are high and making short-term rates high in those countries, and that is what sets up the attraction for funds to move from the United States to those countries.

Senator BUSH. I appreciate that.

Dr. TOBIN. If our economic position were similar to theirs, this would not be a problem to us.

Senator BUSH. I appreciate this is one of our problems. The point I am making is that we are making too much of a problem out of it. In other words, I don't think interest rates in these other countries are holding back progress, industrial activity, and so forth. They are doing very well. The interest rates, as we agreed a moment ago, are a reflection of the goood conditions that they are enjoying in industry and commerce. Higher interest rates are the price of active business, so to speak. Is that not so?

Dr. TOBIN. That is so. The situations which create active business in those countries are not creating active business in our country at the moment. At the time when they are booming in Europe we have been having a recession. So that the appropriate policy for us has been different from the appropriate policy and level of interest rates for them.

Senator BUSH. I don't believe a recession that we have been having has been the result of high interest rates, do you?

Dr. TOBIN. It would be normal, whatever the recession is the result of, for the monetary authorities to let short-term interest rates fall and help them fall a good bit more than has been done in this recession. They have done so in the previous two recessions—let the discount rate go down further, and the Treasury bill rate go down further, in order to expand bank reserves and bank lending and lower interest rates all across the board. They have not been able to do so in this recession, or they have not done so in this recession up to now, because of the problem of the international constraint.

Senator BUSH. I just want to pin this one down, Dr. Tobin. I have not heard it seriously held that the recession currently, which we hope we are coming out of at the present time, was the result of high interest rates. I have heard a lot of other things suggested, such as inventory—excessive inventory buildup—and the liquidation of those inventories held responsible for this most recent recession. I have not heard it seriously held that high interest rates have caused this recession.

Dr. TOBIN. Senator, I would not say high interest rates were the cause of the recession. The fact is, however, that interest rates rose very rapidly in the recovery which started from the trough of the previous recession in 1958.

Had interest rates been kept from moving up so rapidly it is possible that the boom would have taken us to higher levels of activity than it actually did in the end. There were also other factors in the recession, such as the change in the fiscal position of the Federal Government, and the turnaround in inventory accumulation was the proximate cause of the recession in 1960. But whatever the causes of the recession had been, one of the remedies would be to have a monetary stimulus to the economy. The remedies can not always be just the reverse of the cause. The Federal Government does not have direct control over inventories and what it can do to get us out of the recession may be in the monetary sphere.

Senator BUSH. I think my time is about up. I would just like to observe that I think more emphasis should be put on other factors, such as the incentive factor to go ahead and expand and invest. This is not aided by artificially depressing interest rates. I don't believe that. I don't believe the history of the countries of this world would prove that at all. That is one of the things that disturbs me very much about the current situation.

Dr. HELLER. May I add, Senator, as an observation on this, that to stimulate investment does require operating on several fronts at once. One is the direct incentive front on which there will be a program presented to the Congress very shortly, as we have indicated. Another is the stimulation of consumer markets which are the ultimate source of profits for business. This involves a combination of the positive expenditure programs and constructive deficits of which we spoke.

A third is to keep the price of money low so that more money will be used. Surely we do not want to raise the price of money if we want to see more money used in investment. This essentially is the underpinning of the policy that Mr. Tobin was addressing himself to, of holding down interest rates. Then when investment has been restored, when the economy is operating at high levels, of course the opposite policy is to be followed, namely, that the rate of interest should rise to tend to constrict what might otherwise be an inflationary expansion of investment.

Senator BUSH. I think my time is up, Mr. Chairman, but I would just like to say in closing that I do not think the history of this country would show that periods of prosperity have been deterred by interest rates at higher levels than we have today. I don't believe that with our level of interest rates on a worldwide basis, really much lower than any other large country, that so much emphasis should be placed upon this situation to the extent of trying artificially to depress interest rates from an already low level to a lower level. I yield the floor on that.

Senator PROXMIRE (presiding). Mr. Curtis.

Representative CURTIS. If I may on that point, we have had testimony in the past from panels before this committee where they argued the other way around. That the interest rate has little bearing on the actual investment and the use of money. It is my own observation that the interest rate is largely an indicator of what is going on. In other words, if you have a great demand for money in relation to the supply, your interest rates go up. It is true that the Federal Government can modify it slightly, but essentially it is the marketplace forces that bring this about. It strikes me that with the interest rate low the observation made that we didn't have enough money doesn't seem to hold water. It looks like if the interest rates were higher, then there might be an indication that there was a lack of money available. Don't you agree, because that is one of the questions I asked and I was very pleased with the answer. I was worried about your use of the verb, as I recall it, "will be" or "must be," I believe you had, and I raised the question whether the verb should not be "will be." You say "must be." I will read it.

"Monetary policy must at all times be flexible and interest rate must be higher in booms than in recessions."

I was wondering about the use of the word "must be," as opposed to "will be," because "must be" suggests some force other than economic force. Is your opinion that the Federal Government can set interest rates through political forces sufficiently powerful to control the economic forces here at play? I thought your answer was pretty good but now I am confused again.

Dr. HELLER. Our answer, in effect, said that the Federal Government is part of the economic forces in the market that sets interest rates, as, indeed, are all governments.

Representative CURTIS. That is true, but a minor force.

Dr. HELLER. The exact relative importance of that force, I am sure, is open to difference of opinion. The Federal Government has shown in its operations in the past that it can be, and indeed has been, a considerable force in the markets by its influence on the marginal factors. As it enters into the picture through its injections or withdrawals of funds from the market, it has had a considerable effect.

Chairman Martin refers to this as leaning against the movements, the wind, one way or another. Right now he says he is trying to lean against crosswinds. This suggests that he, too, sees quite a role for the Federal Government.

Representative CURTIS. Yes, but it is an indicator. What he is trying to do, as I understand his theory of the Federal Reserve which I happen to agree with, he is trying to reflect economic forces. If he only had the wisdom or any human being did to know really what all the forces were, all he would be doing would be reflecting that and pointing them up. He would not be actually trying to influence them one way or another. He would be trying to reflect them. The way Government affects interest rates is more in its fiscal policy, as I see it, and the Government as a consumer. We certainly could influence rates on public housing and VA housing. There the reason that interest rates make a difference is that we have pegged them artificially at a certain figure, so that as the economic forces play around that figure, if they go up above we have no housing built, and as we go down, then there is housing built. This made of VA and public housing, and even FHA, a contracyclical device, although no one had anticipated it. Again it emphasizes a key question: Should the Government's position be one of trying to reflect what is going on in the marketplace, with the Government as one of the demanders in the marketplace, or should the Government be actually trying to manipulate interest rates.

Dr. HELLER. As far as the Government operations in both the debt management and open market and rediscount rate policies are concerned, it presumably manages the monetary affairs so as to compensate in part for the adverse movements in the private economy. That is, when money is too tight relative to the economic situation in the private economy, the Federal Reserve has on past occasions very successfully loosened the funds available to the private economy. It has also pursued the opposite policy in a period of economic boom.

Representative CURTIS. But the economic factor they are trying to weigh for long-term evaluation, how much economic growth has there been and the money supply should be related to that. It is because of our inability through economic statistics and the fact that these are difficult things to measure, that creates this band and therefore does require this fluctuation. But the desired thing, as a I unstand it, is to have a money supply keep pace with good healthy economic growth.

Dr. HELLER. At times that will require positive action on the part of the Federal Reserve to inject funds in the market.

Representative CURTIS. But only in a slight band, otherwise they create inflation or they could create deflation. I think that is the theory. Isn't that the theory, that it is within this rather narrow band that there can be this fluctuation? That is because, I have always interpreted it, our inability to measure this exactly. If we actually knew what the economic growth was—and that is a very difficult thing to know under circumstances because there is a lack of knowledge—am I wrong in that interpretation of what I understand, Mr. Martin's theory is?

Dr. HELLER. We can't speak with assurance on Mr. Martin's views in this matter.

Representative CURTIS. I didn't mean it that way. I meant his expression.

Dr. HELLER. Let us talk about its actual activities in the market for a moment, because these are facts that we can examine and interpret. At the present time there have been purchases of intermediate- and long-term Government securities by the Federal Reserve System. What does this do? This decreases the supply of those securities in the market and increases the funds bidding for long-term paper. This bids up the price of long-term paper which is the same thing as reducing interest rate.

Representative CURTIS. That is right.

Dr. HELLER. In this respect the Government can be an important factor in the market for long-term bonds as well as for short terms.

Representative CURTIS. I think we are talking about a matter of degree, and that itself could be very important basically. If it is a narrow band, as I have described it, in which monetary policy can do this in, without creating economic damage, that is one thing.

If it is a broader band, as apparently you suggest, that is something else. I want to go back briefly to be sure that I recognize our differences on the one question on this model that you have, actual demand versus potential, which frankly I am very disturbed about. Although I think it is an interesting intellectual exercise, and I think it is of value and I enjoy it, I think it is so far removed from reality that it can create considerable mischief. Yet this is the base, as I see it, of the economic philosophy that you presented in your original paper and you are presenting here and upon which the Congress would be making some very basic judgments. There is this gap, as you have referred to it, in our economy. When we get to excess capacity, and you quote here the figures in textiles and several other industries—I have been interested in how they measure capacity. It has been my judgment that they don't do a very good job of distinguishing between obsolete equipment that really ought to be junked and that which is up to date. Yet when we consider capacity we would be including and do include a lot of this obsolescence. The more rapidly we grow economically, and this is the key, the more the obsolescence is bound to be. That is not waste or unnecessary waste. Again I think that is necessary waste. If we are going to move rapidly we are going to be junking inefficient machines, machines that have been replaced by something that is a great deal more efficient in the same way we are creating obsolete skills and we have to junk them, as it were, and retrain. I don't see that in your model you relate capacity to this growth phenomenon and allow for this factor of obsolescence in our capacity.

Dr. HELLER. May I ask Mr. Gordon to comment on this?

Representative CURTIS. Surely.

Dr. GORDON. Mr. Curtis, it seems to me it is worth while pointing out that the figures you have referred to show sharp changes in the degree of utilization of capacity in a period of less than a year. This would cast a question, I think, on the proposition that a large part of the explanation is an increase in the amount of obsolescent equipment.

Representative CURTIS. Let me make this observation. When you have a less demand, a company will tend to utilize its most efficient equipment and not use the inefficient. When they get into a period when there is a real demand they will even haul out old dogs that they had really been ready to send out to the junk heap. You can have such a thing as overcapacity such as in the Korean war when the steel capacity was above a hundred. I could not understand that at first. I found out that they were not shutting down for what would be regarded as normal maintenance.

Dr. GORDON. I think in general, Mr. Curtis, these capacity estimates are not based on someone's view as to what the maximum possible rate of production is, but on what the industry itself regards as a desirable rate.

Representative CURTIS. That is what I am not sure about. You may be right. But it seems very important. If you are going to allow this model to be such a base for your conception of what is happening in our economy, I think we have to get down to more refinement in these tools.

As I suggest, the unemployment insurance program is a more accurate one for measuring unemployment, allowing for the one observation you made, including the new working force, with which I agree. But this business of measuring capacity. I think those figures are quite loose. In fact, they measure them differently in the textile industry as compared to steel. I have found out that much about it. I am not sure that we have an economic tool that is that good. Maybe after going into that you would still come out with your model. But because it is so important and so basic in the economic concept, I think that we have to refine these figures more.

Then in my judgment we have to distinguish between what I would call the necessary waste—if we are using the term waste, that which is bound to occur and which is an element of production and moving ahead—and how that varies as you move more rapidly. The more rapid our technological advancement, obviously the more obsolescence. The very people who seem to be saying we should be growing more, measured in this gross national product indicator, are the ones who, in my judgment, don't want to face up to these problems of obsolescence in both equipment and skills. When you come and call that wasted economic potential that is where I think you really miss the boat. That is a necessary product of growth. That doesn't mean we can't solve it. I think we should. I think we should be directing our attention to it. But the solution, if that analysis is correct, is entirely different than the solution that the Kennedy administration has been setting forth in many of its proposals.

Dr. HELLER. Mr. Curtis. I want to be sure that we are on the same wave length in describing this necessary waste. I don't believe you mean to say, do you, that 6.9 percent unemployment, for example, represents necessary economic waste?

Representative CURTIS. It could. I don't know enough about it. I have yet to see anyone who studied it enough to know. In other words, I have yet to see an economist come forward and distinguish between unemployment in a dynamic economy, one that is growing rapidly technologically and one that is not growing. In a rather stable economy, you can have a very low incidence of unemployment in theory and in practice because you don't change your skills very rapidly. You don't have innovation. If it is true that 30 percent of our product and services were not even on the market 5 years ago, that indicates a tremendous rapid movement here, and almost an upheaval. In agriculture it is revolutionary. We have people who used to be gainfully employed in agriculture with skills that are not in demand at all. The mechanical cotton picker has displaced I don't know how many thousands of unskilled laborers who no longer can make a living that way. The more rapid this growth is the greater that incidence is going to be. That is what I am trying to point out. So when you say 6.9, I don't know because we have not dug into who are the unemployed. Where does all this unemployment come from?

Our statistics are not good enough. We have not even made studies in this area. Yet here we are going ahead with programs based upon this concept when we don't know. That is all I am saying.

Dr. HELLER. I think that the economy itself has provided us with some pretty impressive evidence within the past 12 to 18 months that it is capable of operating at a rate considerably higher than it is now. When we go back 12 months, we were operating at a level of unemployment of about 4.8 percent. I believe most economists would accept the proposition that arise from 4.8 to 6.9 percent in about a year is not attributable to long-run structural factors.

Of the 4.8 percent I doubt that most economists would judge, or studies would show, that all of that was structural and frictional. Side by side with that, there is the fact that about a year ago we were operating at well over 80 percent of our capacity, according to the McGraw-Hill index. That is, the ratio of output to capacity, was well over 80 percent as against a preferred operating rate, apropos of what Mr. Gordon was saying before, of about 94 percent. So it would seem that just the movement of the economy in the past couple of years has demonstrated that we are capable of a good deal higher level of operation.

Representative CURTIS. Quite the contrary, because the long-range economy has been moving in cycles. It is apparently an action which is not a steady thing but moves like this (indicating). I don't know why but it has been occurring over a period of many, many years. When you try to relate this demand to something like a wasted economic potential, or let us say a lack of demand—consumer demand—or to try to give more consumer dollars out and describe something that is a long-term phenomenon, such as the ups and downs of the cycle, then I take this cyclical movement of the economy from recession to peak and so forth as the result of a lot of forces that we have not yet analyzed.

I think what we are trying to talk about on the unemployment is this nagging or, rather, persistent high incidence of unemployment as we move through these cycles. It is that area that I suggest that probably is the result of rapid economic growth and it is in the structural area. If that is so, getting back to this, we are not talking about wasted economic potential. The bulk of this is the result of rapid economic growth. If we want more economic growth, we better be ready to meet the problem of a greater incident of structural unemployment. Yet we can meet it successfully if we analyze it properly.

Don't misunderstand. In analyzing this problem, I am not saying it is beyond our capacity to take care of it. I think we can do it. My suggestion, incidentally, has been in the area of unemployment insurance and putting in a new ingredient. If a person is on unemployment insurance, the present test is could he get a job. I say there should be two tests. Can he get a job, and if he can't then he should go to school for retraining and have the system pay for it. My suggested remedy or solution to a big part of this problem would be at variance with yours. It depends upon this analysis.

Dr. HELLER. In that connection we comment rather directly on your observation and your question where you refer to the growing pains argument.

Representative CURTIS. Yes.

Dr. HELLER. If I may, I would like to quote that answer because it bears directly on this point.

Representative CURTIS. I wish you would.

Dr. HELLER. We certainly do not believe that the U.S. economy is tired, sluggish, or sick. Its potential is enormous, but we cannot be satisfied with our recent economic performance. It is impossible to accept current levels of unemployment as simplying the "growing pains" of a rapidly growing economy because there is no independent evidence that the economy is growing rapidly. Progress in invention, science, and management skills do not themselves constitute rapid growth. They represent a great potential for growth, which it is the responsibility of private initiative and public policy to realize. Otherwise we will have growing pains without growth.

Rapid growth both creates, and helps to solve, problems of economic adjustment and adaptation. Dynamic growth inevitably entails redundancy of some skills and specialized capital, while at the same time creating demands for new skills and new capital. The long-term growth record of the American economy is evidence that we have solved these problems in the past, and we are confident that we can continue to solve them in the future.

There is some problem of redundancy. But side by side with abundancy there should be growth of new demands, new expansion, new capacity, which will absorb the people who are displaced in the technological process.

Representative CURTIS. We are in complete accord with that analysis. I say there is a time lag and a geographical problem in this rapid growth which displaces some skills and creates the new. In my speech I illustrated the prime example in our society is in the rural areas where today as the result of amazing technological advancement, referring to your statement "advance in science and management skills do not represent economic growth" but these skills and innovations have come in. So today one man is producing the food and fiber that used to take five men to produce. We have a problem involved in what I say is not an agriculture problem at all, but rural unemployment. You have these obsolete skills. How do you adjust those so you bring them over into the areas where the demand for new skills have been created? I would observe this: In every one of these so-called depressed areas, there is a great demand for skills that apparently are unavailable, and at the same period we have this so-called 6.9 percent unemployment. There is not an area in this country that you won't see advertisements for skills. In fact, some skills they don't even advertise for any more because they find it is a waste of money because the skills aren't there.

Senator PROXMIRE. I am going to interrupt to say that the Congressman has taken 22 minutes of his 10-minute period.

Representative CURTIS. I believe I have.

Senator PROXMIRE. I would appreciate it, Dr. Heller, if you would reply, and then I will take my 10-minute period and then if the Congressman wishes to go ahead he may.

Representative CURTIS. I am sorry, Mr. Chairman, if I had been told I would have confined myself to the 10 minutes because, as the author of the 10-minute rule, I intend to observe it.

Dr. GORDON. I can comment very briefly on your last observation, Congressman. We certainly agree most wholeheartedly on the need for effective programs of retraining in the current situation. I think, however, that we stress somewhat more heavily than you do the need to help create a strong demand for labor in expanded sectors as a way of providing outlets for the new skills which emerge from the retraining process.

Senator PROXMIRE. Now I would like to return to the point I was trying to press about what we can do about this situation. I do want to touch very quickly and lightly on the monetary policy situation which Senator Bush and Congressman Curtis have so ably pursued. I notice in your statement on March 6, Dr. Heller, you say—

> residential construction has been further depressed by high interest rates on mortgages.
>
> It is difficult to accept the view that the housing market is so glutted that it would not respond to lower monthly financing costs. The possibility for such reduction through lower interest rates are substantial. For example, a reduction of 1 percent on the rate of interest on a 30-year mortgage could reduce monthly mortgage payments by more than 10 percent.

The administration has proposed a no-downpayment, 40-year, very low cost method of buying housing. They hope it will work, as I do and many people do. Could you reply roughly as to what would be the effect if the present 6 percent rate on home mortgages were reduced to the average in 1953–54 of 4.7 percent. Say roughly a 1.3 percent reduction in interest, how much would that reduce this what I think is now a $53 a month payment for this low-cost housing. Would it reduce it in the neighborhood of up to $46 or $47 a month?

Dr. GORDON. I am afraid, Senator, I do not have those figures at my fingertips. I do remember the figure, I think, that in the case of a 30-year mortgage, a 1 percent reduction in the interest rate from 6 to 5 percent would reduce monthly carrying charges by more than the extension of the maturity period from 30 to 40 years. It would suggest a very substantial effect of interest rate reduction.

Senator PROXMIRE. So in this case it would go down more than 10 percent. More than $5.30 from $53 because it is 40 years and not 30 years, it is more than 1 percent that I am hypothesizing, I think you might get in the neighborhood of $46 a month payments. It seems to me that the difference between people who can pay $53 a month for housing and $45 a month for housing would open up literally hundreds of thousands of additional housing starts and put literally hundreds of thousands of people to work and millions of people to work. For every man who worked on the housing site there are two at work supplying material for housing. Therefore it would seem to me if we could do this, and I am not saying the Federal Reserve will get the interest rate down this much, that we can see that here at least there would be an immediate and direct and obvious impact on employment and stimulating the economy in this housing field.

Dr. GORDON. I think that is unquestionably correct, sir. I would point out that some progress has been made in the last couple of months in reducing effective rates on mortgages. But I think it is also necessary to stress that the mortgage market is a part of the money market and what it is possible to achieve with respect to mortgage rates is very closely related to yields on other long-term securities which are substitutes for mortgages. It is necessary to take into account what is happening in the general market for long-term bonds.

Senator PROXMIRE. I understand. The fact that the high interest rate on home mortgages in the 1953–54 period of high activity was 4.8 percent. If we can get down to that level we could open up a lot of jobs.

Dr. GORDON. Yes.

Senator PROXMIRE. Now to go on, Dr. Heller, I fully appreciate your position on depreciation incentives and the President is about to make a statement. I am asking you to give me your reply as to a factual answer rather than an opinion. In the first place, it seems to me that this is a kind of tricky thing. That is, increasing the depreciation allowance. It is true that it would provide an incentive for additional capital investment by business. But it is also possible, and perhaps the experience with the 1954 Revenue Act would suggest whether or not this is true, that you simply borrow from the future. In other words, we had a great capital investment boom in 1955–57 followed by a very sharp dropoff since then. Do you think that there is any relationship between the Revenue Act of 1954 and (a) the boom, and (b) the fall off.

Dr. HELLER. The acceleration of depreciation allowance for tax purposes in 1954 unquestionably increased the profitability of investment in plant and equipment. Unfortunately, we don't have a test-tube basis for determining how much of that investment could be attributed to this particular increase.

Senator PROXMIRE. Could it not be argued that while it had a stimulating effect at that time it might have had a depressing effect later on inasmuch as business stepped in at that time and bought the equipment they needed and made the purchases in 1955, 1956, and 1957 that they might have made later.

Dr. HELLER. At any given time the faster you can accelerate and the faster you can depreciate for tax purposes on a given investment, the more, in effect, you increase the profitability of that investment. Incidentally, I am not here suggesting or endorsing any particular method. My point applies whether we are talking about accelerated depreciation or an initial allowance or investment credit or so forth. These are all part of a general family to which I think your comments are addressed. What presumably reduced the level of plant and equipment investment after the 1955–57 boom was an insufficiency of market demand. That is always a relative thing, and how to separate the two and say to what extent the rate of investment was too high and to what extent the rate of consumer demand was too low is again a matter of judgment and not a matter of absolutes.

Senator PROXMIRE. In the morning's Wall Street Journal the Machine and Applied Products Institute is reported to contend that there are some seven industrial countries comparable with ours, all of which have enjoyed a far higher rate of industrial production expansion since 1953. The rates given are: United States 119 percent in 1960 of what it was in 1953, Canada 127, England 128, Sweden 134, France 172, Germany 180, Italy 181, and Japan 258. They go on to say as against the U.S. writeoff in the first year of 13 percent, Japan and England permit more than 15 percent, Sweden 40 percent, Canada almost 30 percent, and France almost 20 percent.

For the first 3 years in which the permitted rate in our country is 35 percent, England and Sweden allowed more than 70 percent, Japan and Italy more than 60 percent, Canada more than 50 percent, and France almost 50 percent.

Do you think there is any real connection between liberalized depreciation and industrial expansion or do you think there were other factors that were perhaps more important than this more liberalized depreciation allowance in this country?

Dr. HELLER. I think there are a whole series of factors including extremely strong consumer markets which have given a great impetus to expansionary investment. There have certainly been great technological advances. It has not been based wholly on their own technological advances but in part on the stockpile of technology that was built up in the United States. In other words, they are modernizing to a very considerable extent.

Senator PROXMIRE. Isn't one of the reasons they are modernizing is because they do have this more liberalized depreciation?

Dr. HELLER. I am sure that the more liberal tax treatment is helpful. If we are going to operate at all as economists, Senator, we have to admit that when there are higher profit rates supported by very strong markets (for example, the development of the European Common Market has opened up vast markets to its members) that combination is going to stimulate more investment than would strong markets with a lower rate of profit per unit of output. Insofar as these very generous tax provisions have increased the rate of profit one would have to conclude as an economic fact that this was a stimulus to some of the investment which took place in these countries during the past decade.

Senator PROXMIRE. Then I take it you would feel that no matter what we did with liberalizing depreciation allowances, that an absolute necessary prerequisite to having this effective is a strong demand. The demand must go along with this order to make it effective.

Dr. HELLER. I would say that for an adequate level of investment and economic growth we need to have both strong consumer markets and a profitability per unit of output that represents an attractive rate of return on investment.

Senator PROXMIRE. This indicates that a governmental policy which was based primarily on improved depreciation or, exclusively on improved depreciation allowances, would be inadequate because it doesn't strike at the demand factor which you say is also necessary.

Dr. HELLER. Senator, if you mean that it would be inadequate as an economic recovery program, I would certainly agree. It is not intended primarily as a short run antirecession program. It is intended rather as a longrun improvement in the relation of capital investment to our total national output, i.e., an increase in the amount of investment, in turn bringing down costs and making us more competitive in world markets.

Senator PROXMIRE. But you don't make the investment, you don't buy the equipment unless you have the market; is that not correct?

Dr. HELLER. At any given level of market demand, if you have a way of lowering costs you can still find advantage in investment. But to make the program work fully in the way intended you need to work on both fronts.

Senator PROXMIRE. I see. So you would say there would be an incentive (even though the demand remained constant) for buying new equipment?

Dr. HELLER. Yes, there would.

Senator PROXMIRE. Provided the depreciation was more liberal?

Dr. HELLER. That is correct.

Senator PROXMIRE. But to buy equipment that would expand production you would need additional demand. You replace it at lower cost, all by itself without any additional provision, would increase or tend to increase capital investment.

Dr. HELLER. It would tend to increase incentives and increase capital investments, yes.

Senator PROXMIRE. Would you say it is true that the principal impediment to renewal and modernization of industrial equipment has been insufficient depreciation?

Dr. HELLER. Again it is hard to say what the principal impediment has been.

Senator PROXMIRE. Do you think it has been an impediment?

Dr. HELLER. Let me put it this way: I think there are other factors that have been more important. The market has been perhaps the most important impediment. But I would rather turn the statement around, as I have before, and say that if you increase profitability per unit you could increase incentives for investment.

Senator PROXMIRE. Without asking you what the President is recommending, isn't it true that anything of this kind tends to favor the large business as compared with the small business if only because the small business pays its taxes up to a certain minimum level at 30 percent whereas the largest business pays the 52 percent, and therefore any depreciation allowance is bound to accrue to the competitive advantage of big business as contrasted with small business.

Dr. HELLER. Senator, I think the point you are raising is important in determining the form of incentive or tax provisions devised. It is entirely possible to devise a tax incentive which will not have this suggested perverse effect between large business and small business that you are now outlining, and it is up to the ingenuity of the administration to suggest methods that will be at least equally stimulating or, indeed, more stimulating, to small business than to large business.

Senator PROXMIRE. I think Senator Sparkman has proposed a small business depreciation bill which would specifically assist small business much more than it would big business and perhaps these two things combined might work out a kind of rough equity. You are familiar with that?

Dr. HELLER. I think he will be very interested in the proposal that is made on this score.

Senator PROXMIRE. Very good. I have just one more question. Did you notice in the New York Times yesterday an article in which it projected unemployment in one area of Russia and estimated that this might indicate that there are 3 million or even more than 3 million people out of work in Russia?

Dr. HELLER. I didn't happen to notice it.

Senator PROXMIRE. It seems to me this is an extremely interesting economic phenomena. It might suggest that a totalitarian monolithic state like Russia has many great advantages maybe they don't have as sharp an advantage in utilizing all of their resources as we previously expected.

Of course, you have not seen the article. Perhaps it is premature to ask for an explanation of it. It seems to me rather puzzling in view of the argument which has been rarely challenged that they can have virtually full-time employment.

Dr. HELLER. I would say that in the private market mechanism which we regard as a fairly efficient machine we have to allow for some structural and frictional unemployment, and I imagine this is a phenomenon that cannot be totally legislated out of existence even in a totalitarian economy.

Senator PROXMIRE. To wrap my whole line of questioning up, then, you would feel, I take it—this is perhaps unfair—that the tools that are now available to the President and the Congress to reduce unemployment to a level of 4 percent are not only limited but that there is some question as to whether or not they will be able to do the job in a period of 18 months or 24 months in view of the fact, as you pointed out, you can have a balanced budget with 6 percent unemployment. The President has limited authority in lowering interest rates; the prospect of tax incentives, while it can be very useful in a moderate way, is also limited, and any other proposals that we have heard so much about, like research and education, are quite vague and quite hard to assess in terms of their effect in reducing unemployment.

Would you agree with me that the present outlook over the next 2 years of reducing unemployment below the level of 4½ percent is not good?

Dr. HELLER. That raises so many questions that it is difficult to handle in a brief answer. Let me make a few observations. First, we do face a tough and stubborn problem of getting back to a satisfactory level of high employment. Second, I think that the tools themselves, monetary and fiscal policy, are adequate to the job. However, they operate under certain constraints today—international constraints, political constraints, constraints of public understanding of some of the problems—which means that full use of these available tools cannot be made. Our economic problem will not and cannot be solved overnight.

Third, however, let me say that the combined programs which are being proposed, if enacted, would be a very substantial contribution to the recovery. Combined with the naturally regenerative forces of the private economy—for example, the turnaround of inventories which is surely coming; the undoubted increase in productivity that will occur on the upswing; the hopes we have for a more stimulated housing market; and the increase in State and local spending, which will occur in spite of difficulties—these programs will insure that we are not condemned to stagnation in the sense of the gross national product not moving up.

Indeed, to achieve the estimated gross national product underlying the budget estimates, we will have to have something like $520 to $525 billion of gross national product in the fourth quarter of this year.

Senator PROXMIRE. And still have enormous unemployment.

Dr. HELLER. But in spite of a substantial absolute increase in gross national product, we will still have a very tough problem of unemployment and a difficult problem of getting back to the intermediate goal of 4 percent unemployment. This is not a cause for despair. This is a cause for determination to keep on top of this situation and to propose additional measures as experience shows us the exact dimensions of the problem relative to the programs that are adopted and relative to the inherent forces in the private economy.

Senator PROXMIRE. I am not advocating a course of despair. I am saying we must open our eyes to the problem—all of us who are responsible, including the public—and see how important it is to use fiscal and monetary policy and tax incentives and all the other tools that we can envision that we are going to have to use, if we are going to come close to providing jobs for any large proportion of the 5½ million people who are out of work.

Dr. HELLER. I think that is an affirmative note on which I would be happy to close this part of the discussion. I would agree with that entirely.

Representative CURTIS. I have just one statistical point. Inasmuch as Senator Proxmire is chairman on our Subcommittee on Statistics, I would ask in relation to housing, why don't we include in our housing starts the home trailer industry? That is becoming increasingly larger. I used to follow it. There are now over 200,000 trailers manufactured a year if I am not mistaken about that. There is an interesting development that the trailer companies seem to be the ones really going in a massive way for prefabs, where real mass production of homes will come.

I thought perhaps you or the staff have the figures on these movable homes. I don't think they call them trailers anymore. But it is becoming large enough to warrant some study. In order to get a real understanding of the housing picture they ought to be included or related to the housing starts.

Dr. GORDON. I would be glad to look into that and submit a statement for the record. That figure is a very striking one. I am very curious to look into it.

Representative CURTIS. About 4 years ago in one of the hearings I looked into it and I was talking to someone in the industry about a week ago and as I recall what he said it is over 200,000 a year now. If it is that, that is a sizable figure.

Dr. GORDON. I would be glad to look into it.

(The information requested is as follows:)

DATA ON MOBILE HOMES

The Department of Commerce started publishing in the March 1961 issue of Construction Review a new monthly series on manufacturers' shipments of mobile homes and travel-trailers. These data are not included in the new Census housing series. Monthly data for the two types of trailers are available beginning with 1959 and annual data for total only beginning with 1952. A mobile home, or housing-type trailer, is a vehicular portable structure built on a chassis and designed to be used without a permanent foundation as a year round dwelling when connected to utilities. Mobile homes range in size from 29 to 60 feet long and 8 to 10 feet wide. Travel-trailers are less than 29 feet in length regardless of width, and less than 4,500 pounds regardless of length. The data in the following table do not include units designed for commercial uses, pickup cabs, folding campers, or amphibious units.

Year	Total units	Mobile homes (more than 29 feet long)	Travel trailers (less than 29 feet long)
1952	83,000	(1)	(1)
1953	76,900	(1)	(1)
1954	76,000	(1)	(1)
1955	111,780	(1)	(1)
1956	139,690	(1)	(1)
1957	143,490	(1)	(1)
1958	133,800	(1)	(1)
1959	162,500	120,500	42,000
1960	141,090	99,310	41,780

[1] Not available.

Sources: Mobile Homes Manufacturers' Association.

Senator PROXMIRE. Thank you very much, Dr. Heller, Mr. Tobin, and Dr. Gordon.

The committee will stand in recess until 2 p.m., at which time the Assistant Secretary of Defense, Charles Hitch will testify.

(Whereupon, at 1 p.m., the hearing in the above-entitled matter was recessed, to be reconvened at 2 p.m. of the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will please come to order.

Mr. Hitch, we are glad to have you sir. I notice that you have a prepared statement. You may proceed either way, either put your prepared statement in the record and elaborate on it, or use it as a text and deliver it as is.

You may proceed in your own way, sir.

STATEMENT OF CHARLES J. HITCH, ASSISTANT SECRETARY OF DEFENSE, DEPARTMENT OF DEFENSE; ACCOMPANIED BY GRAEME C. BANNERMAN, DEPUTY ASSISTANT SECRETARY (PROCUREMENT), DEPARTMENT OF DEFENSE

Mr. HITCH. Thank you, Mr. Chairman. I think I will proceed by reading this prepared statement although I may diverge from it at one or two points.

The CHAIRMAN. That will be satisfactory, sir.

Mr. HITCH. Mr. Chairman and members of the committee, it is indeed a great pleasure for me to appear before this committee. Although an economist by profession, I am not here today in that role but rather as the spokesman for the Defense Department.

I recognize, of course, that as members of this committee, you are interested in the defense program primarily as it affects the economic situation now and over the next year or two. Although the Defense Department is conscious of the impact its programs have on the economy, our primary concern, of necessity, is with military requirements. President Kennedy's proposed revisions to the fiscal year 1962 defense program and budget, transmitted to the Congress on March 28, are based solely on national security considerations. The acceleration and expansion of certain defense programs which will result from the recommendations of the President will, of course, contribute to the general level of economic activity. But this contribution is a byproduct, and not an end in itself.

Of course, like any other Federal agency having business relations with the private economy, the Department of Defense attempts to maximize the placement of supply contracts in areas currently designated as having substantial labor surplus—where this can be done consistent with efficient performance of the contract and at prices no higher than are obtainable elsewhere. Similarly, it is the policy of the Department of Defense to place a fair proportion of its total purchases and contracts for supplies and services with small business concerns. The Office of the Secretary of Defense has recently increased its target for small business' share of total contracts from 16.1 to 17.7 percent in fiscal year 1962. It should be noted, however, that the defense programs for both small business and surplus labor areas reflect continuing policies which are Government-wide in their application.

There is one other way in which the Defense Department, at the request of the President, has recently responded to the needs of the current economic situation. Together with all other Government departments and agencies, we have sought wherever feasible and sensible, to accelerate the placement of contracts for programs already approved. In this case, however, we are simply buying the same things, or doing the same things, somewhat earlier than had originally been planned.

But even here the Defense Department is quite limited in what it can prudently do. Most of our programs are closely interrelated and are geared to specific military requirements and time-phased schedules. It is not easy, nor would it be desirable, to accelerate such programs on any basis other than military need.

However, there are certain activities such as the procurement of common items of supply, and the repair, rehabilitation, and modernization of the existing plant which can be scheduled so as to assist in meeting the exigencies of the present economic situation. It is in these areas that the Defense Department in February sought to accelerate the obligation of funds within the programs already approved by the Congress. The net effect of those actions was to move forward into fiscal year 1961 about $151 million in obligations which otherwise would have been made after the end of this fiscal year. This is roughly one-quarter of the $660 million in Government-wide accelerated obligations announced by President Kennedy at that time.

In addition, the Defense budget revisions proposed by President Kennedy in his special message would raise obligations in fiscal years 1961 and 1962 by about $2 billion—about $700 million in 1961 and $1.4 billion in 1962.

In evaluating the impact of the defense program on the economy, there are two fiscal measures which are of particular importance—obligations and expenditures. Obligations, as you know, measure the value of contract placements and other work undertaken during a given period of time. Expenditures reflect the actual payments made by the Defense Department, in a given period, against obligations made at various earlier times.

While defense expenditures, as is well understood, stimulate economic activity, defense obligations also have an important impact.

An "obligation" made by the Defense Department for hard goods is a "new order" received by the durable goods manufacturing industry. What is an "unpaid obligation" to the Defense Department is an unfilled order to industry. To the extent that changes in new orders and backlog affect the direction and level of economic activity, defense obligations and unpaid obligations similarly affect economic activity.

It might be useful, therefore, to examine the trend in Defense Department obligations over the last few years. I will use for this purpose our series on "Gross obligations" even though they include some double counting, interdepartmental transactions. These are the only obligation figures available monthly on a consistent basis. Fortunately, the amount of double counting, resulting from intradepartmental transactions, is relatively modest and fairly constant from year to year.

Gross obligations in fiscal year 1960 totaled $42.5 billion compared with $44.5 billion in fiscal year 1959. On the basis of President Kennedy's revised budget, gross obligations in 1961, the current fiscal year, are expected to total almost $48 billion, about $5.5 billion more than fiscal year 1960 and about $3 billion more than in fiscal year 1959. Indeed, obligations now planned for the current fiscal year will be the highest since the end of World War II, except for fiscal year 1952, the peak year of obligations during the Korean war buildup.

Gross obligations of about $47 billion are now planned for fiscal year 1962, about three-quarters of a billion dollars less than 1961 but still about $4.5 billion more than in 1960. The peaking of obligations in 1961 reflects to a large extent the acceleration of certain key programs, such as Polaris and airlift aircraft and the carryover into 1961 of obligations originally planned for 1960.

Most of the increase in obligations will occur in what we call the "Capital cost" or "Investment" categories—in procurement; in research, development, test, and evaluation; and in military construction. Operating costs—military personnel and operation and maintenace—which have been increasing steadily in recent years—steadily but solwly—will rise again by one-half billion dollars in 1962 to a total of $24½ billion.

Obligations for procurement, R.D.T. & E., and construction, which amounted to nearly $19 billion in fiscal year 1960, are expected to increase to about $23¾ billion in 1961—again the highest level of any year since 1952. In 1962 obligations for these categories will continue at a high level, although a billion dolars or so below the current year.

The annual figuers tend to obscure some significant shorter term trends. For the first half of fiscal year 1961 (July–December 1960) gross obligations for the three "investment" categories totaled $10.3 billion leaving, according to the current financial plan, about $13½ billion to be obligated during the second half of the fiscal year (January–June 1961). Obligations in January and February for these categories totaled slightly more than $3 billion. However, March is normally a big month for obligations. We would guess that the total for the third quarter could amount to about $5 billion, about the same as for the second quarter, leaving about $8½ billion to be obligated in the final quarter (April–June 1961).

Obligations of $8½ billion in the final quarter of the current fiscal year would be considerably greater than the amount obligated in the final quarter in each of the past 2 years, but only about three-quarters of a billion dollars more than the amount obligated in the final quarter of fiscal year 1958. I would judge, therefore, that the $8½ billion target is within the realm of the attainable. The stimulating effect of such an increase in industry's new orders should be highly significant for the recovery..

Obviously, the $8½ billion per quarter rate, indicated for the final quarter of this fiscal year, cannot be continued during fiscal year 1962. Allowing for the usual seasonal pattern, we estimate that perhaps $9 to $10 billion will be obligated in the first half of the fiscal year (July–December 1961)——

Representative CURTIS. Pardon me. Is that an error there? Mine says "July–December 1961." You read it "1962."

Mr. HITCH. The first half of fiscal 1962.

Representative CURTIS. Is this a typographical error?

Mr. HITCH. No; during the first half of fiscal 1962, which is July–December 1961.

Representative CURTIS. I follow.

Mr. HITCH. And $12 to $13 billion in the second half of that fiscal year, which is January–June, 1962.

Up to this point, I have been discussing gross obligations. On an annual basis, we are also able to estimate direct obligations, or obligations for the services' own accounts only. These are, of course, a more precise indicator of the actual level of Defense activity, because they exclude these intradepartmental transactions.

For fiscal year 1962, direct obligations are estimated at $44¾ billion. This compares with over $45 billion in this fiscal year, and the $40 billion in fiscal year 1960.

You might be interested in a more detailed review of these planned direct obligations for fiscal years 1961 and 1962 in terms of the different functional title groupings.

Direct obligations for military personnel, which include the pay, allowances, subsistence, clothing, and certain travel expenses of the Active and Reserve Forces, and retired pay, are estimated at $12½ billion for fiscal year 1962—up about a half billion dollars from 1960.

Obligations for operation and maintenance are estimated at about $11 billion for the coming fiscal year—about $300 million more than the current fiscal year and $800 million more than for fiscal year 1960.

Procurement obligations are planned at over $15 billion for the coming fiscal year—nearly $1 billion less than the current fiscal year, but $2½ billion more than in 1960.

Aircraft procurement in the coming fiscal year will be more than a billion dollars lower than fiscal year 1961.

Obligations for missiles, on the other hand, will reach $4 billion more in fiscal year 1962—somewhat less than the current year, but over a half billion dollars more than 1960.

Obligations for ships will total over $2½ billion in the coming fiscal year—up slightly over the current year, and over $1 billion more than fiscal year 1960.

Procurement obligations for equipment and material other than aircraft, missiles and ships will also show an increase in fiscal year 1962, totaling over $3 billion—up about $300 million over the current year and $700 million more than in 1960. The upward trend in this category of procurement reflects the increased emphasis we are placing on so-called conventional weapons and equipment, particularly for the ground forces.

Obligations for research, development, test, and evaluation will continue their upward trend, reaching a total of about $4¾ billion in fiscal year 1962. That is about the same as the current fiscal year but about three-quarter billion dollars more than 1960. Here too, as in the procurement area, increased emphasis is being placed on the development of new nonnuclear weapons and equipment for use in limited war situations and on antisubmarine warfare systems and techniques.

Obligations for military construction on the other hand will continue to decline in the coming fiscal year and will amount to about $1.2 billion—more than $100 million less than the 2 previous years.

The substantial increase in obligations during the current fiscal year will affect expenditures for several years in the future. Based on the revised budget estimates, expenditures during the current fiscal year are estimated at $42.5 billion. This is $1¼ billion more than in fiscal year 1960 and we expect them to rise another $1¼ billion—to $43.8 billion—in fiscal year 1962.

The current estimate for 1961 is $1 billion more than the estimate made in the January budget. The program revisions proposed by President Kennedy would add only about $25 million to 1961 expenditures, but the actions taken to accelerate contract placements in 1961 will add something over $200 million, and a reestimate of the expenditure rate for the programs projected by the previous administration would add another three-quarter billion dollars to 1961 expenditures, making our current estimate $1 billion higher than the estimate that was made in January.

The 1962 expenditure estimate is about $900 million higher than the estimate in the January budget. The changes proposed by President Kennedy would add about $650 million to that estimate and a reestimate of the previous administration's program about another $200 million. The balance of the increase, about $50 million, is related to a proposed fiscal year 1961 supplemental. Thus, 1962 expenditures would be slightly higher than the 1953 peak of the Korean war period, and would be more than $8 billion greater than the post-Korean low in fiscal year 1955.

These are indeed significant increases. But I think it is important to keep them in perspective. As a percentage of gross national product, defense expenditures in fiscal years 1961 and 1962 will probably be no higher than fiscal year 1960—about 8½ percent—and considerably lower than the 12.1 percent in fiscal year 1953, and the 8.9 percent in both fiscal years 1957 and 1958. Even as a percentage of total Federal expenditures, defense outlays will be lower in fiscal years 1961 and 1962 than in any year since the end of the Korean war, except 1959.

The distribution of defense expenditures by budget category has remained fairly stable over the last few years. Military personnel continues to take nearly 30 percent of total expenditures and operation and maintenance, which includes most of our civilian personnel, about 25 percent. Thus, these two categories, constituting the day-to-day operating cost of the Defense Establishment, absorb a little more than half of total defense expenditures.

The proportion of defense expenditures going for procurement has declined slightly in recent years and now represents about a third of the total. Conversely, expenditures for research, development, test, and evaluation have increased from about 6 percent in fiscal years 1957 and 1958 to 10 percent in fiscal year 1962. Expenditures for military construction, however, have declined both absolutely and as a percentage of the total, from 6 percent in fiscal 1956 to only 3 percent in fiscal year 1962.

Within the procurement category, the percentage of expenditures going for aircraft has declined steadily from a peak of almost 70 percent in fiscal year 1955 to an estimated 40 percent in 1962. Procurement expenditures for missiles, on the other hand, have increased very markedly and in the current fiscal year they will account for more than a quarter of the total. Expenditures for ships have run at about 12 percent of total procurement in the last few years, a considerably higher proportion than prevailed in the 1955 to 1957 period. Expenditures for ordnance, vehicles, and related equipment, which took over a quarter of the total in 1953, at the Korean peak, declined sharply to less than 3 percent in 1958. Reflecting the increased emphasis on so-called "conventional" weapons and equipment, expenditures for this purpose, which have risen slowly since that time, will increase more sharply in fiscal year 1962 to over 6 percent. Expenditures for electronics and communications equipment, other than that actually incorporated in aircraft, missiles, and ships, have leveled out at close to 8 percent of the total.

This changing mix of defense expenditures has had a significant impact on those industries most heavily involved in defense work.

Here I am afraid we have to rely on the industry categories as defined by the Standard Industrial Classification Code where the "Defense-oriented" or "Defense-related" industries are aircraft and parts, ordnance and accessories, ship and boat building and repair, and communications equipment. The industry accounting for the largest number of employees in defense work is, of course, aircraft and parts. Employment in this industry has fluctuated rather widely since the end of World War II. During the Korean war, employment rose from about a quarter of a million to a peak of 800,000 by the end of 1953 and then declined to 725,000 by the middle of 1955.

During the next 2 years, employment in the aircraft and parts industry again increased rapidly to a peak of almost 900,000 by the fall of 1957.

Actually, there was no solid long-term basis for this large increase in aircraft industry employment. The defense programs then contemplated could not by any stretch of the imagination support for very long such a high level of employment in that industry. As a result, a rather modest curtailment of defense expenditures in the fall of 1957 precipitated a very sharp decline in employment in the industry—from almost 900,000 to about 750,000 within a period of only 1 year. After a small temporary rise during the second half of 1958 employment in the aircraft industry resumed its decline, although at a slower rate and reached a low of 620,000 by the middle of 1960. Since then there has been a slight rise to a little over 640,000. On the basis of our planned obligations for aircraft and missiles during the balance of the current fiscal year and through the next fiscal year, a further rise in defense-supported aircraft industry employment over the short term is possible, but it will not be very great.

On the basis of the limited data available through the Department of Labor surveys, it is possible to make a more direct comparison of Defense Department expenditures for aircraft and employment on just aircraft in the aircraft and parts industry. Defense expenditures for aircraft declined by about 25 percent from fiscal year 1957 to fiscal year 1960, while aircraft employment was declining just slightly faster. The Labor Department data also show that employment on missile work in all industries increased by about 70 percent from fiscal year 1957 to fiscal year 1960. During the same period, defense expenditures on missiles just about doubled. On the basis of our planned obligations for aircraft and missiles through fiscal year 1962, it would appear that these divergent trends in aircraft and missile employment will continue over the next few years.

Another development of note in the aircraft industry is the continued growth of nonproduction workers as a percentage of total employment. At the peak of employment during the Korean war nonproduction workers represented slightly more than a quarter of total employment in the industry. At the post-Korean low point in employment, nonproduction workers accounted for almost a third of total employment. Since that time, the number of nonproduction workers has grown steadily and they now represent over 40 percent of total employment. This constantly growing proportion of nonproduction workers reflects not only the increased overhead requirements of modern business but also the increasingly advanced technological character of defense work, with a resultant growing requirement for engineers and scientists. It also reflects the growing importance of research, development, test, and evaluation work as compared with straight production work. Thus, while total employment has declined less than 30 percent from the 1957 peak, the number of production workers in the aircraft industry has declined more than 35 percent. Rosy the Riveter just does not seem to be needed any longer.

One final point in connection with the aircraft and parts industry: Average weekly hours worked by production workers in the industry increased rapidly during 1955 and 1956, reaching a peak of almost 43 hours a week by the end of that period. As part of the effort to reduce defense expenditures in the latter part of 1957, aircraft producers working on military contracts were directed to reduce overtime. This action resulted in a sharp drop in average weekly hours from nearly 43 hours per week at the end of 1956 to less than 40 hours by November 1957. Since that time, average weekly hours worked have gradually increased until they now slightly exceed 41 hours per week for the industry as a whole.

While employment in the aircraft and parts industry, as defined by the BLS, has declined significantly in recent years, employment in the ordnance and accessories industry has shown a substantial increase. Employment in this industry, which includes artillery, small arms, tanks, and some missiles, reached a peak of a quarter of a million during the Korean war effort in the middle of 1953, then dropped abruptly to 150,000 a year later. From the middle of 1954 through the end of 1957, employment gradually declined further to a low of 125,000. During 1958 and 1959 it rose again to about 150,000 and held that level through most of 1960.

In recent months, there appears to have been a resumption of the upward trend in employment. We believe that this new rise reflects the increase in Defense procurement of so-called conventional weapons and equipment which I described earlier as well as this industry's expanding missile work.

Considering the composition of the defense programs planned for fiscal years 1961 and 1962, with their increased emphasis on weapon systems using nonnuclear ammunition, the chances are that employment in this industry will continue to grow over the next few years.

Then we come to ships:

Although defense expenditures for ships more than doubled from fiscal year 1957 through fiscal year 1960, employment in the ship and boat building and repairing industry, after rising from 1955 to 1958, declined on the average in 1959 and 1960. There are several reasons for these divergent trends.

First, the expenditure and employment figures are not directly comparable. Shipbuilding employment data, as published by the Department of Labor, includes work in private shipyards only. Conversely, defense expenditures for shipbuilding include work done in both the Navy's own shipyards and in private yards. It is, therefore, necessary to determine employment in all shipyards, Navy and private, and to determine what portion of total employment is accounted for by Navy work and by private work.

Total employment, in all shipyards, private and Government, declined from nearly 300,000 in the second half of 1952 to about 225,000 by the end of 1954. Since that time, total shipyard employment has fluctuated within a narrow range close to a quarter of a million workers. While employment in private shipyards increased about 20 percent from 1955 through 1957 and subsequently leveled off at around 150,000, employment in Navy shipyards has slowly but steadily declined since 1955.

Taking all shipyards together, employment on Navy work declined from a Korean war high of about 185,000 to a low of about 125,000 by the end of calendar year 1957. Since then, employment on Navy work has increased to its present level of about 150,000. By comparison, employment supported by private work now stands at about 90,000—down a quarter from both its Korean war and its 1957 peaks.

But even when we isolate employment on Navy work, there is a marked lack of correlation between the increase in defense expenditures on shipbuilding and employment in all shipyards on Navy work. Although expenditures have doubled from fiscal year 1957 to fiscal year 1960, average employment on Navy work in 1960 was only a few thousand more than in 1957. The major reason for this discrepancy is the rapidly increasing proportion of the defense shipbuilding dollar going for work done outside the shipyard—particularly for electronics, armaments, and powerplants. For exaple, the powerplant in a nuclear-powered submarine represents a much greater proportion of total ship costs than in a conventionally powered submarine and the last conventionally powered submarine was started in 1956.

I would not like to attempt to forecast employment on private work in U.S. shipyards. With regard to employment on Navy work, however, I think it is safe to say that the trend will continue to go up during the next few years on the basis of the large increase in obligations for ships planned for fiscal years 1961 and 1962. For reasons which I have just enumerated, the rise in shipbuilding employment will not be proportionate to the rise in defense expenditures for ships. Much of that employment will be elsewhere in the economy.

As I noted earlier, electronics are taking a large and growing proportion of aircraft, missile, and ship expenditures. Thus, it would not be surprising to find that defense expenditures for electronics and communications equipment have been rising steadily over the last few years. It should be noted that the Defense Department expenditure series for electronics and communications includes only those items which are not installed in an end product, such as an aircraft, missile, or ship. This series, therefore, is not truly representative of the total volume of business received by the communications equipment industry. In this connection, the factory sales of electronics reported by the Electronic Industries Association are perhaps more useful. According to this series, "military products" sales increased from about a half billion dollars in 1950 to $5 billion in 1960, an increase of tenfold in a decade. In fact, military electronics equipment sales have almost doubled since 1955 and now represent about half of total factory sales by the electronics and communications equipment industries.

I believe it is clear from what I have sketched out here today that the defense program over the next year or two will be a positive factor in the economic picture. The impact of this program on industry will, as in recent years, be quite uneven, with some industries benefiting more than others. And, as weapon systems become fewer, but more complex, the impact on individual firms will be even more extreme. The resultant dislocations are regrettable but unavoidable; they are one of the prices we must pay for rapid technological progress in weapons.

Department of Defense expenditures also have an important impact on the U.S. international balance of payments position. Total U.S. defense expenditures entering the international balance of payments in fiscal year 1960 amounted to about $3 billion. Of this $3 billion total, about $150 million of defense expenditures were made in foreign currencies, acquired mainly through sales of agricultural products, and therefore did not contribute to the deficit in our overall balance of payments. Something over $400 million consisted of expenditures for defense-related activities by agencies other than the Department of Defense; and close to $300 million were spent abroad under the military assistance program. Thus, after allowing for these items, dollar expenditures abroad for the military functions of the Defense Department amounted to about $2.2 billion. That was in fiscal 1960.

We can break that down on a fiscal basis as I have done on the top of page 19 of the prepared statement:

Military pay and allowances, a very large item; construction in that year a very large item; civilian pay, somewhat smaller; materials and supplies, a very large item; and contractual services, a very large item.

Representative CURTIS. These are offshore procurement?

Mr. HITCH. Yes. These are dollars spent abroad.

These figures total $2.3 billion and, when we subtract the $139 million paid from local currencies to which I referred, the net dollar expenditures of the Department amounted to about $2.2 billion in foreign currencies.

On a functional basis, fiscal year 1960 expenditures abroad from the regular Defense Department budget break down as follows:

	Million
Military pay and allowances	$673
Major equipment	37
Construction	196
Civilian pay	172
Materials and supplies	541
Contractual services	706

Of this $2.3 billion total, about $139 million is paid from local currencies already owned by the United States. Department of Defense dollar expenditures, therefore, amounted to about the $2.2 billion I mentioned previously.

It should, perhaps, be noted that as an offset to these defense expenditures abroad, sales of equipment and services to foreign governments by or through our own military organizations have been running at the rate of about $300 million and are expected to rise to an annual rate of $400 million or over.

As you are well aware, the overall deficit in the U.S. balance of payments amounted to $3.8 billion, it is estimated, in both 1959 and 1960. In settling this balance of payments deficit, foreign countries withdrew $2 billion of gold in 1960. Virtually all of this gold outflow occurred in the last 6 months of 1960 and it was against this background that President Eisenhower on November 16, 1960, issued his "Balance of Payments" Directive. He sought to alleviate the U.S. balance-of-payments directive. He sought to alleviate the U.S. positive steps to reduce their dollar expenditures abroad.

Because of the relatively large effect of defnese expenditures abroad, a substantial portion of the hoped-for savings were to accomplished through:

(*a*) Limiting the number of dependents of Defense Department military and civilian personnel in foreign countries;

(*b*) Reducing procurement aboard for both the Department of Defense and the military assistance program; and

(*c*) Prohibiting purchases of foreign goods by nonappropriated funds activities of the Defense Department.

Immediately upon taking office, President Kennedy ordered a reappraisal of the balance of payments situation with particular reference to the reduction in the dependents of Department of Defense personnel overseas. His conclusion was that, while it was clear that the U.S. must exercise maximum prudence in its dollar outlays abroad, the limitations on dependents travel to overseas areas, ordered by the previous administration, was not the best way to accomplish the needed savings. The limitation was seriously damaging morale in the armed services. Accordingly, on February 1, 1961, the President directed the Secretary of Defense to rescind the order, but to find and implement alternative measures which would produce equivalent dollar savings, including limitations on expenditures abroad by miltary personnel for the purchase of durable consumer goods. He further directed that the policy inaugurated in November, emphasizing procurement in the United States for our military forces abroad, be continued wherever practicable, even though some increased budgetary cost might be incurred.

As a result, it is now anticipated that savings on Department of Defense dollars, entering the international balance of payments in calendar year 1961 will total about $170 million. About $80 million in savings will result from decreased expenditures by military and civilian personnel overseas. (This is equal to the expected 1961 savings under the earlier dependent reduction program.) The previously planned actions to save $65 million by procuring equipment and supplies in the United States where the cost differential does not amount to more than 25 percent will be continued, as will the actions to save $25 million in the military assistance program.

It is now planned to take additional steps so that total savings will at least match those anticipated under the Eisenhower directive, not only this year but next year and in subsequent years.

For example, as announced by President Kennedy in his special message of March 28, the Department of Defense has selected 21 oversea installations or components to be discontinued or modified. When fully effected in 2 or 3 years, these closings should result in annual foreign exchange savings of approximately $100 million.

Additional steps under consideration might include consolidations and reductions in overhead personnel which do not adversely affect combat strength, the combined use of facilities with our allies, et cetera. All of these measures will be vigorously implemented in an attempt to make a maximum contribution to correcting the deficit in the U.S. balance of payments. But they will be pursued only insofar as they do not diminish our effective military strength.

Over the immediate future, the trend of U.S. defense expenditures, entering the international balance of payments, will be downward in any event and we are not claiming credit for some of this reduction. Certain programs involving oversea expenditures such as construction, military assistance program, offshore procurement, and the national security activities of other agencies were already planned to decline. The lower level of funding required by these programs will also help in alleviating our payments problem.

Mr. Chairman, we have prepared a series of tables and charts in support of this statement. We hope that they will be of some assistance to the committee and its staff. If additional information or explanation is desired, we will, as in the past, be glad to provide it.

I understood from your staff that there might be some interest in and some questions on procurement procedures and policy in connection with this statement and I, therefore, brought with me Mr. Bannerman of the Office of the Assistant Secretary for Installations and Logistics. He is Deputy Assistant Secretary for Procurement and has a first hand knowledge of these problems that I do not at the moment possess.

Thank you.

The CHAIRMAN. Thank you, sir.

Do you say you have some charts and tables in addition to what you have here?

Mr. HITCH. They have been provided, sir.

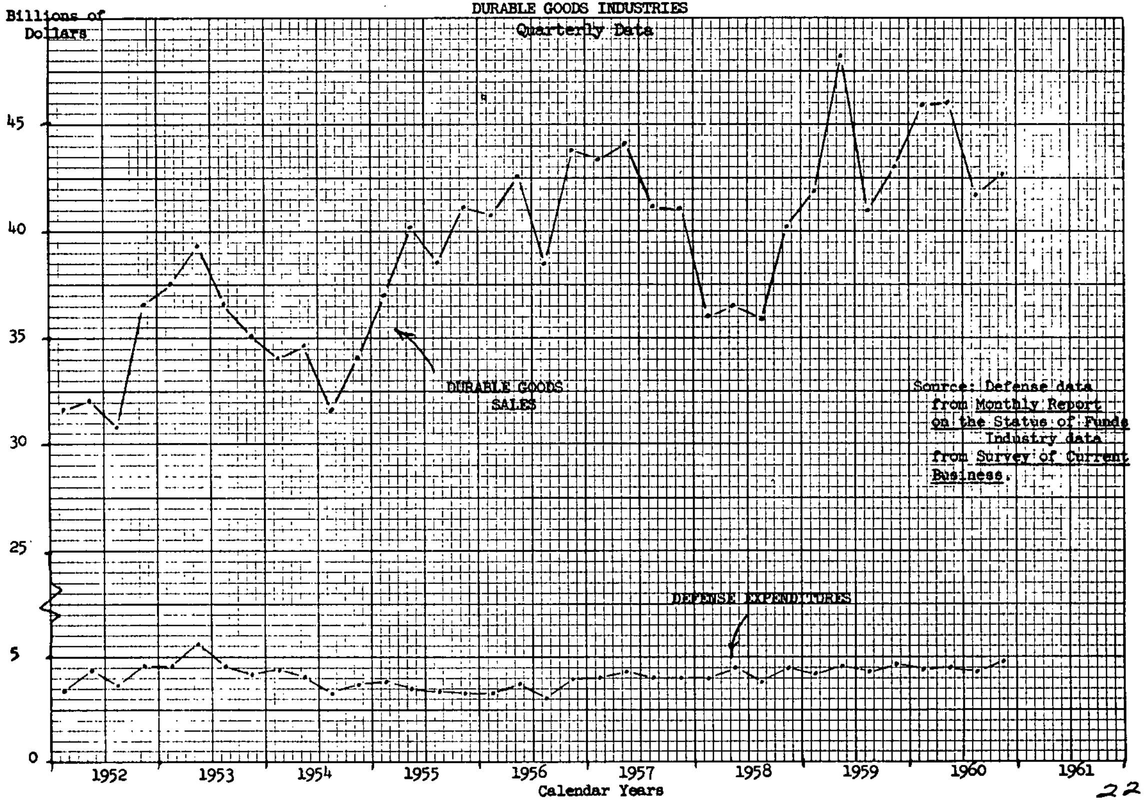
The CHAIRMAN. I assume that you would want these in the record. They are part of your statement?

Mr. HITCH. Yes, indeed. I would want them in the record.

The CHAIRMAN. Without objection, these will be inserted in the record at this point.

(The charts and tables follow:)

DEPARTMENT OF DEFENSE NET EXPENDITURES FOR PROCUREMENT AND RESEARCH DEVELOPMENT, TEST AND EVALUATION COMPARED WITH SALES IN THE DURABLE GOODS INDUSTRIES



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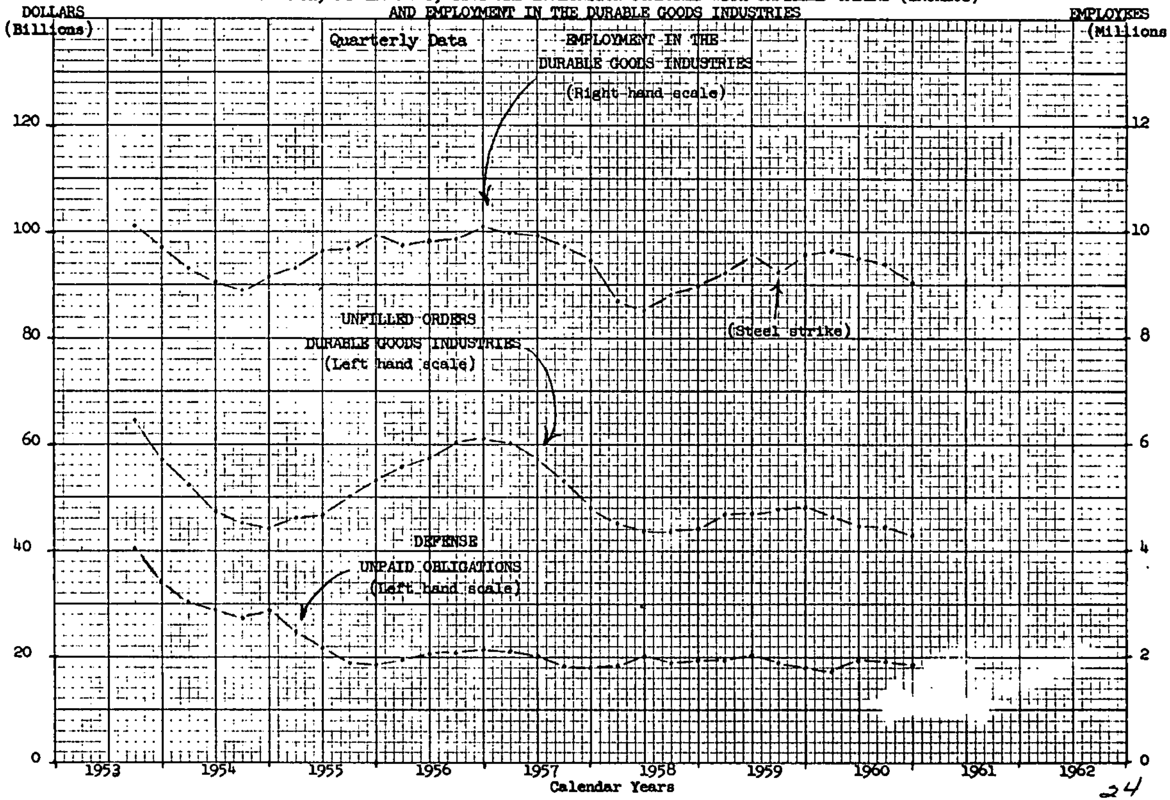
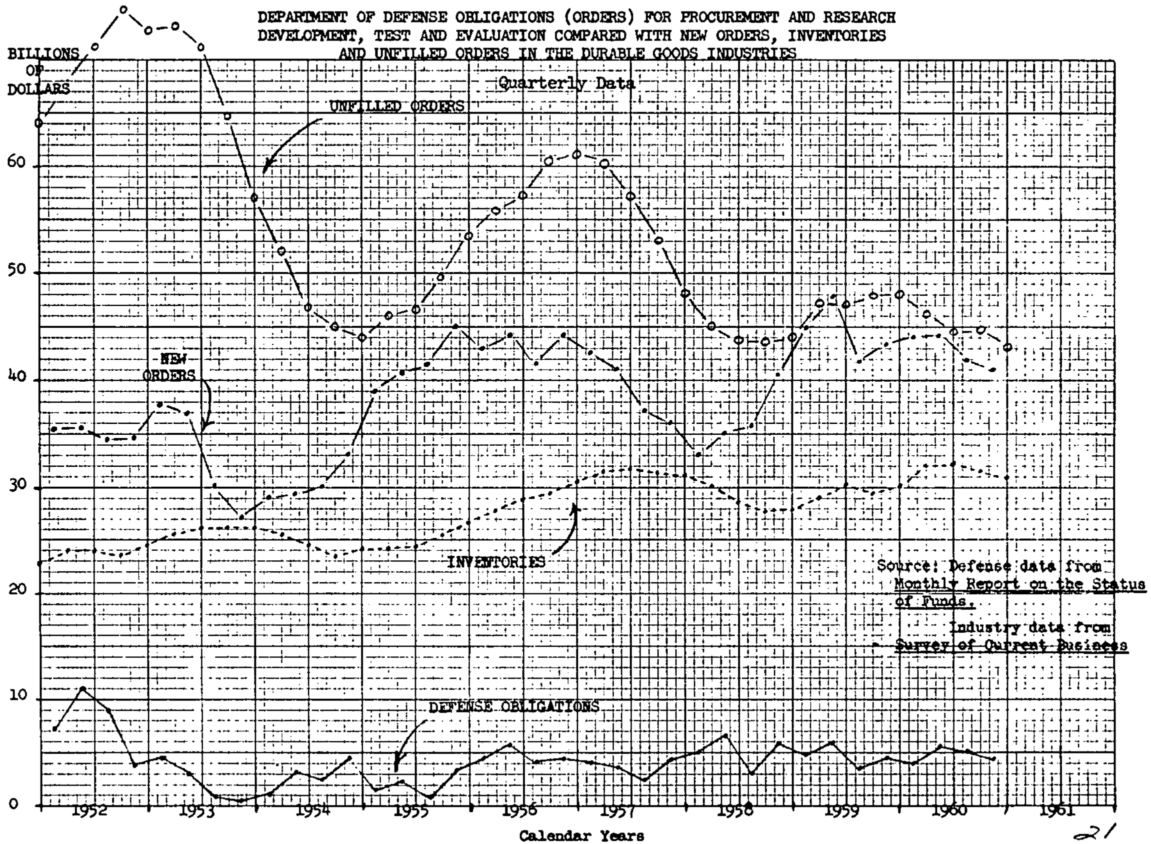
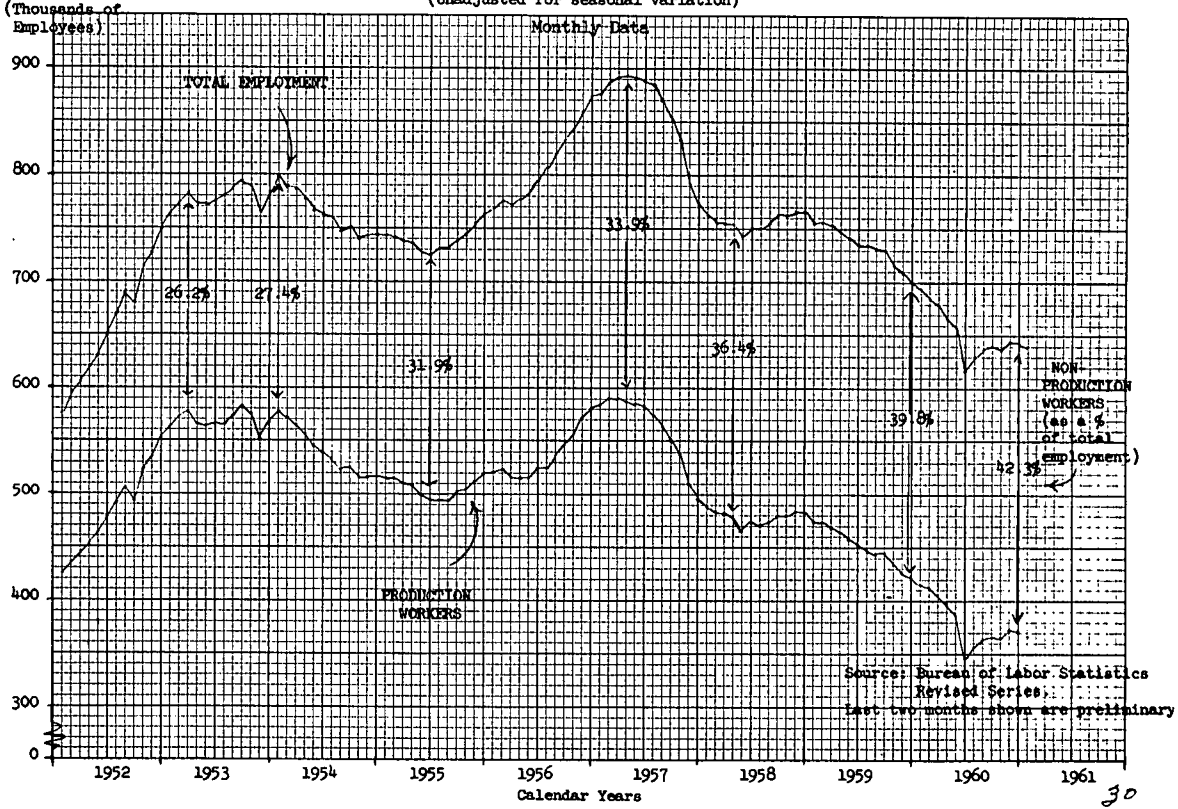
DEPARTMENT OF DEFENSE UNPAID OBLIGATIONS (OUTSTANDING ORDERS) FOR PROCUREMENT AND RESEARCH, DEVELOPMENT, TEST AND EVALUATION COMPARED WITH UNFILLED ORDERS (BACKLOG) AND EMPLOYMENT IN THE DURABLE GOODS INDUSTRIES



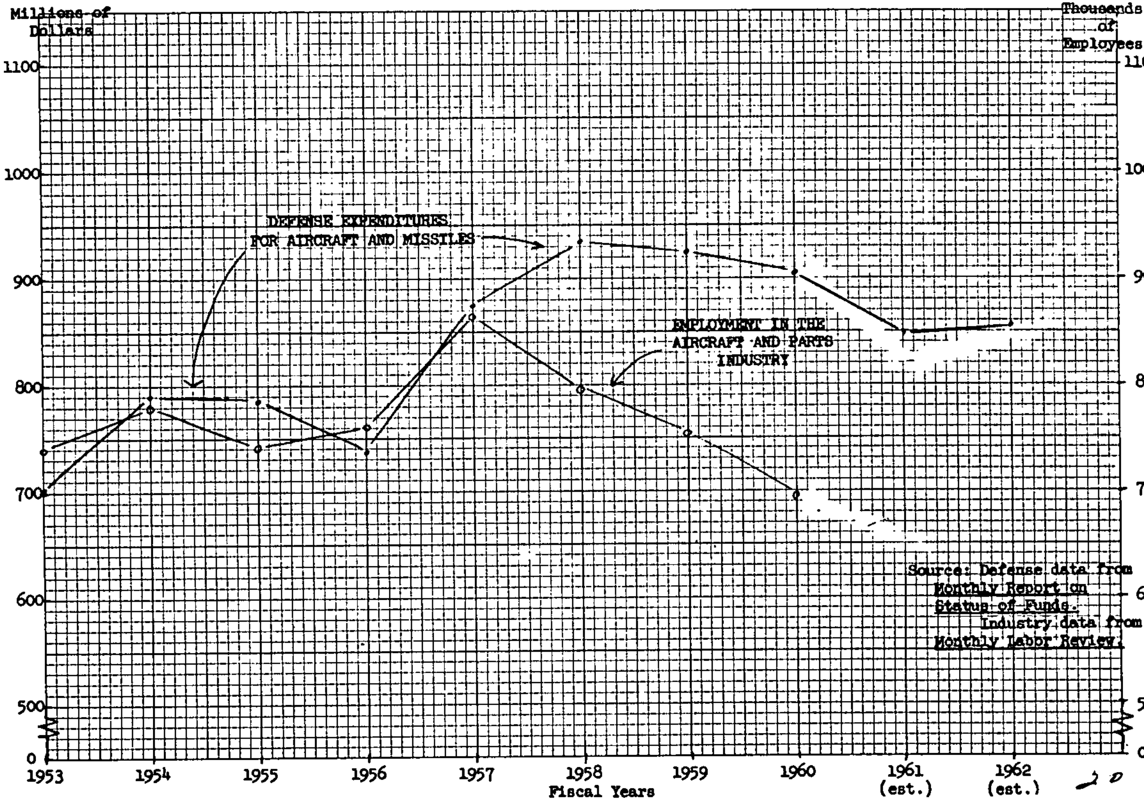
DEPARTMENT OF DEFENSE OBLIGATIONS (ORDERS) FOR PROCUREMENT AND RESEARCH DEVELOPMENT, TEST AND EVALUATION COMPARED WITH NEW ORDERS, INVENTORIES AND UNFILLED ORDERS IN THE DURABLE GOODS INDUSTRIES



EMPLOYMENT IN THE "AIRCRAFT AND PARTS" INDUSTRY
(Unadjusted for seasonal variation)

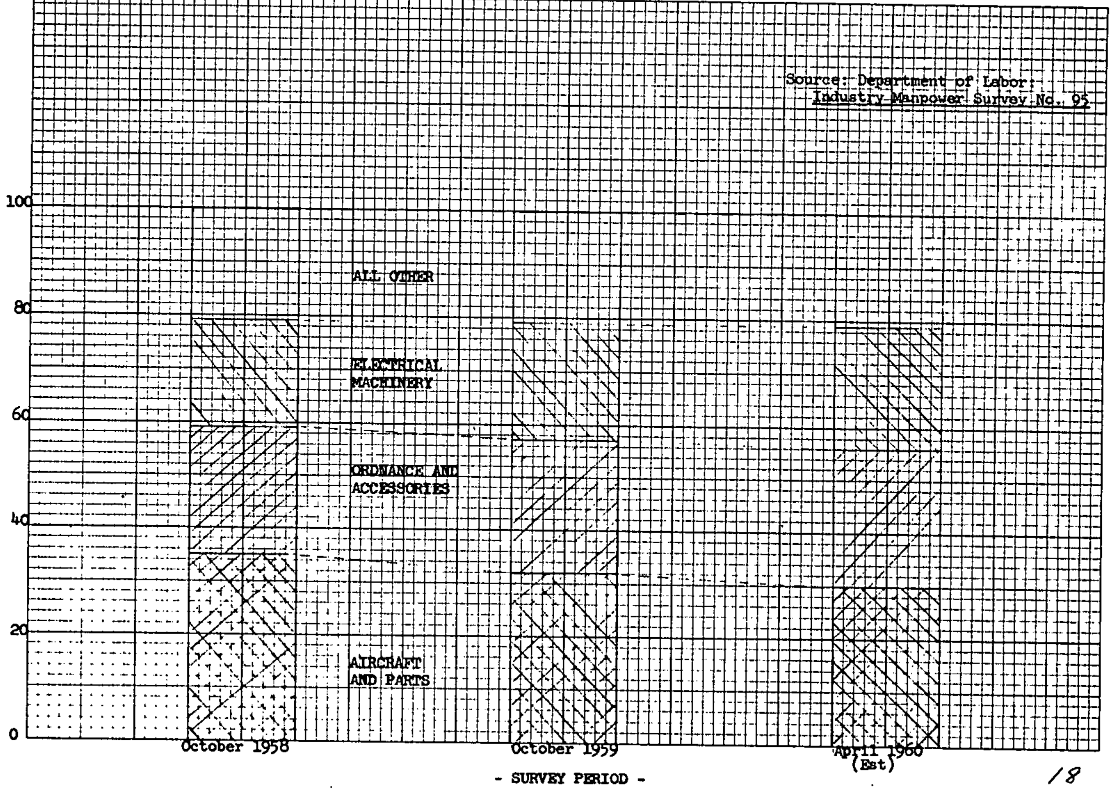


AVERAGE MONTHLY DEFENSE EXPENDITURES FOR AIRCRAFT AND MISSILES COMPARED WITH AVERAGE MONTHLY EMPLOYMENT IN THE AIRCRAFT AND PARTS INDUSTRY



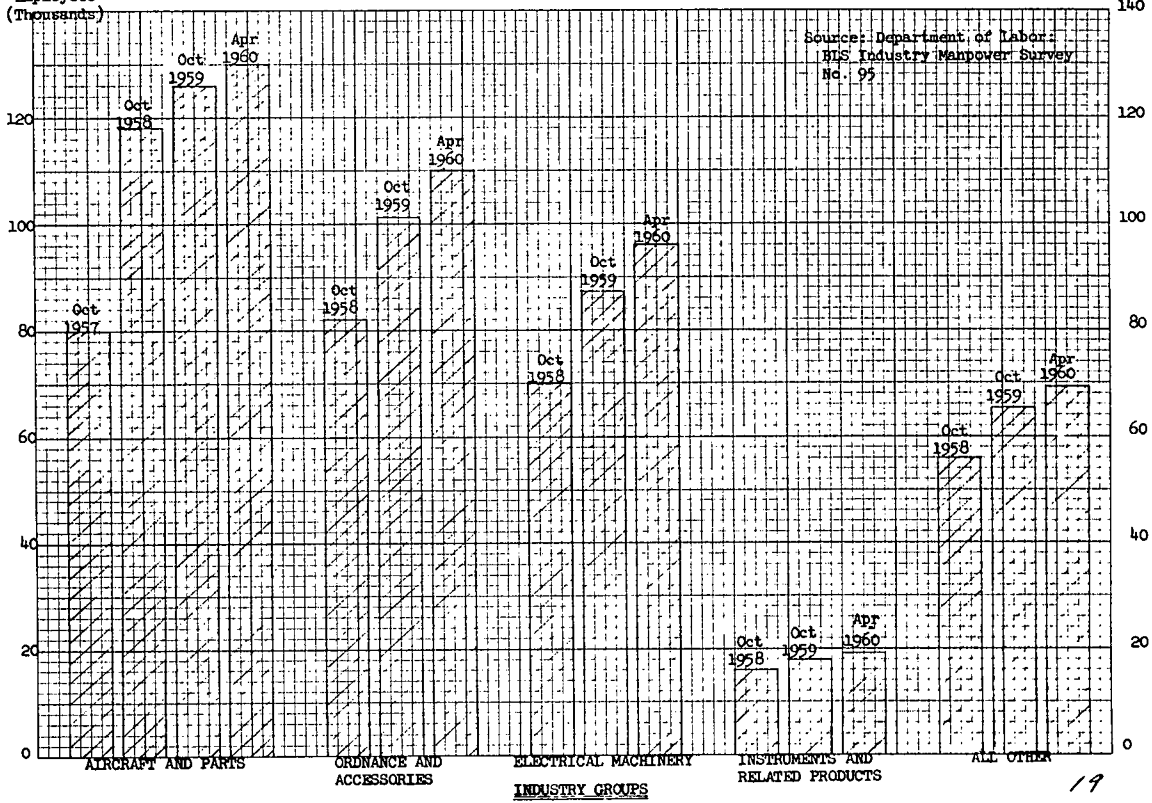
Percent

PERCENTAGE DISTRIBUTION OF TOTAL MISSILE EMPLOYMENT AMONG MAJOR INDUSTRY GROUPS



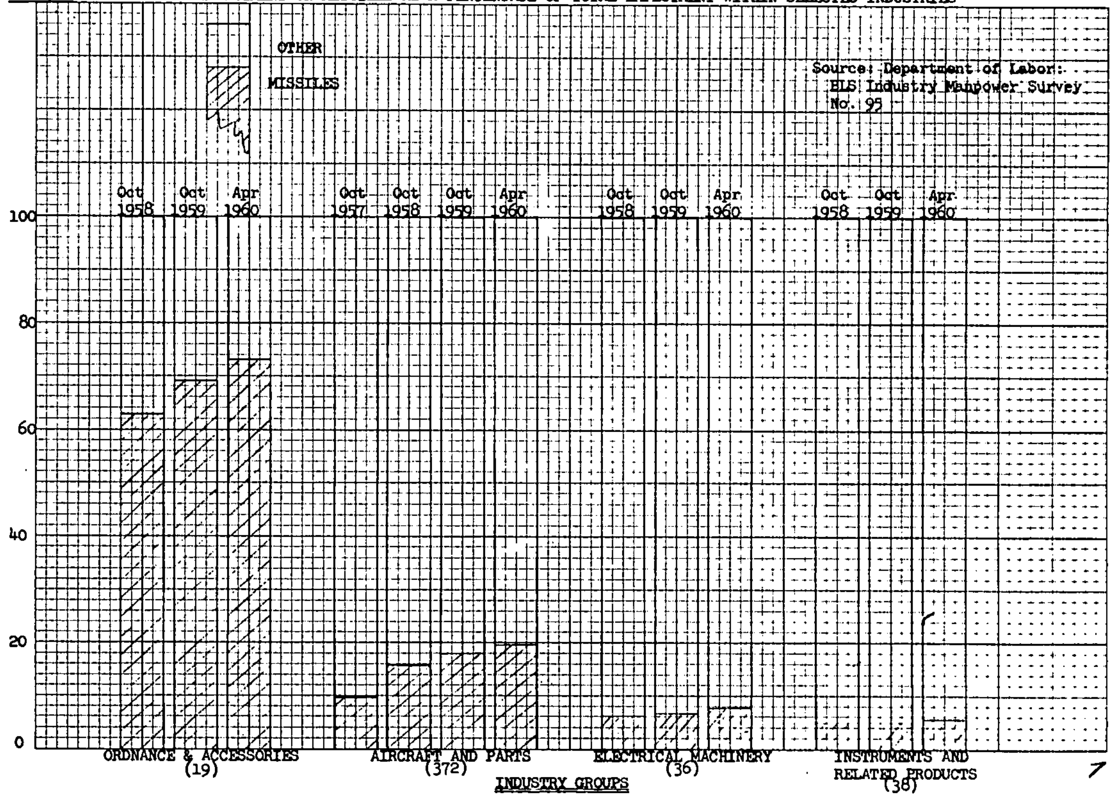
18

EMPLOYMENT ON MISSILES WITHIN SELECTED INDUSTRIES



19

EMPLOYMENT ON MISSILES AS A PERCENTAGE OF TOTAL EMPLOYMENT WITHIN SELECTED INDUSTRIES



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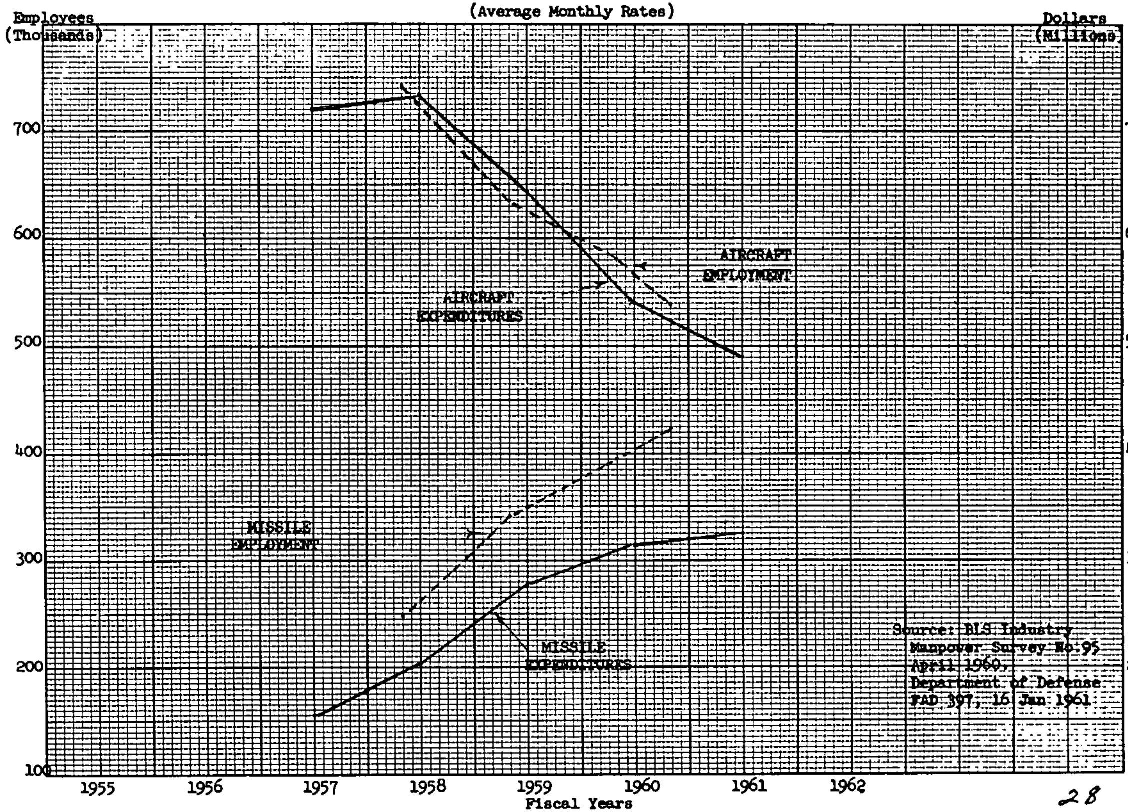
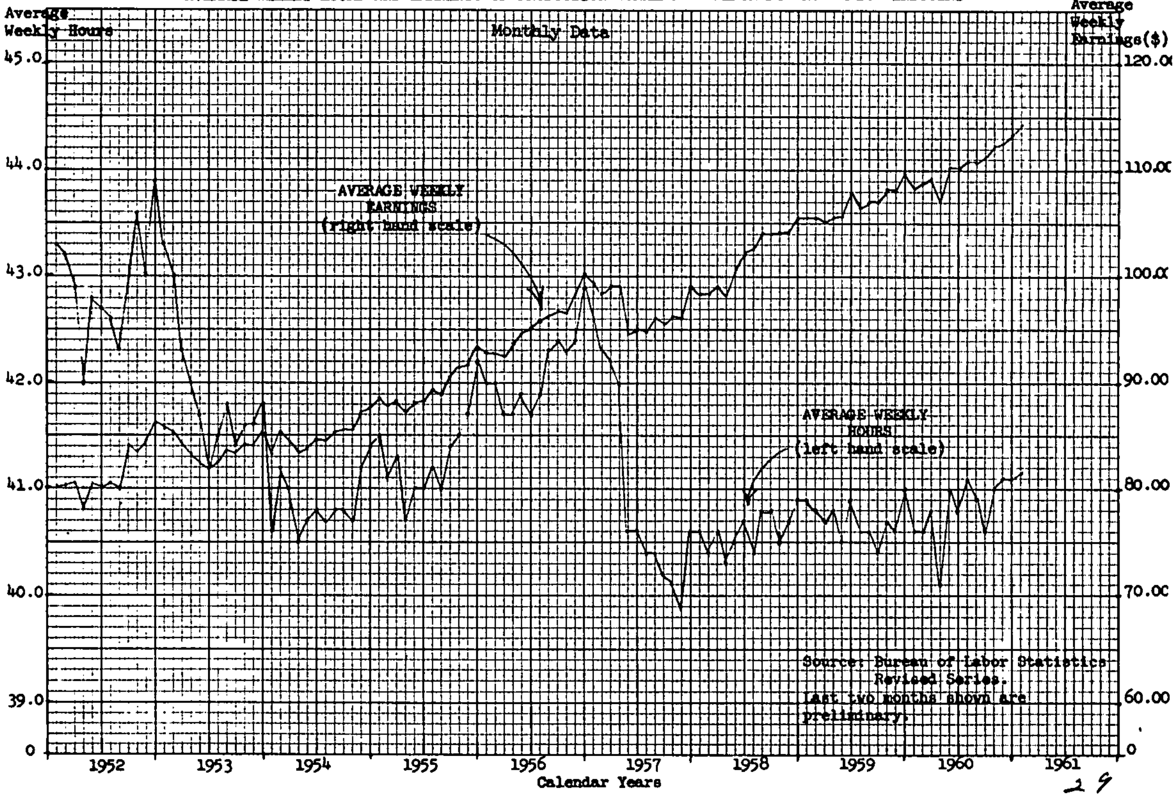
DEFENSE EXPENDITURES FOR AIRCRAFT AND MISSILES vs EMPLOYMENT
(Average Monthly Rates)

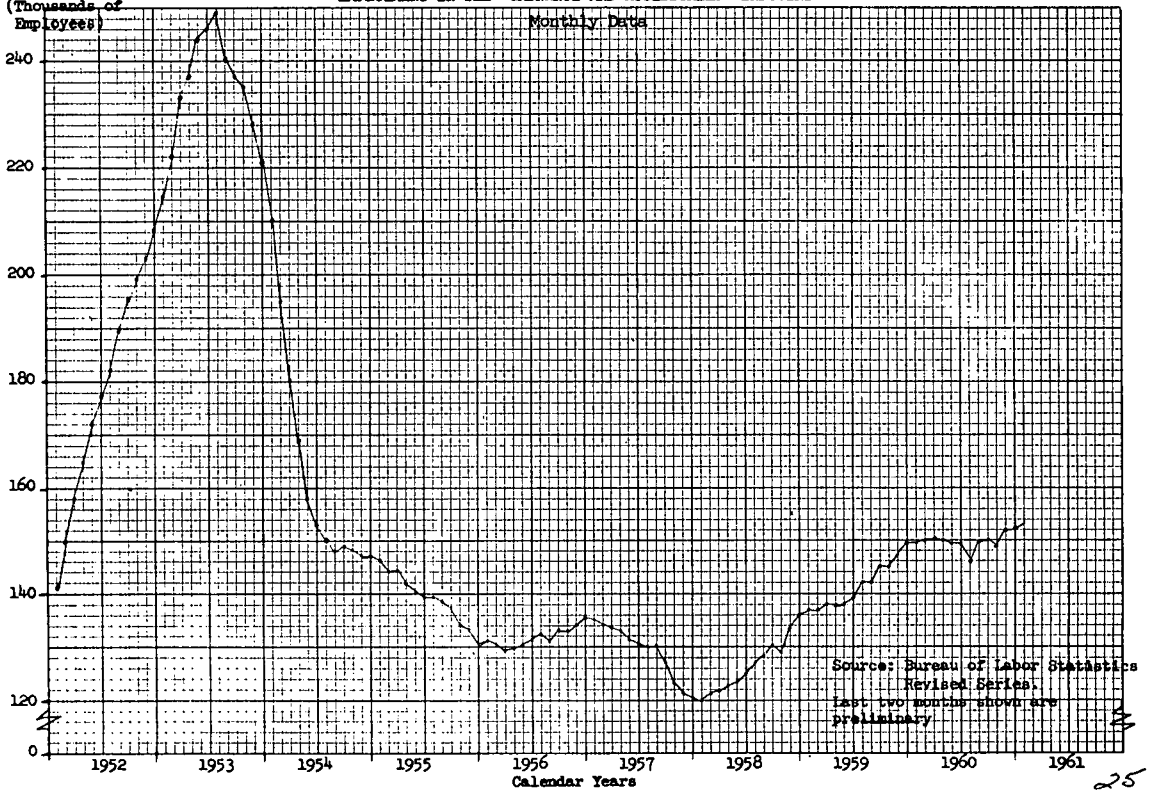


28

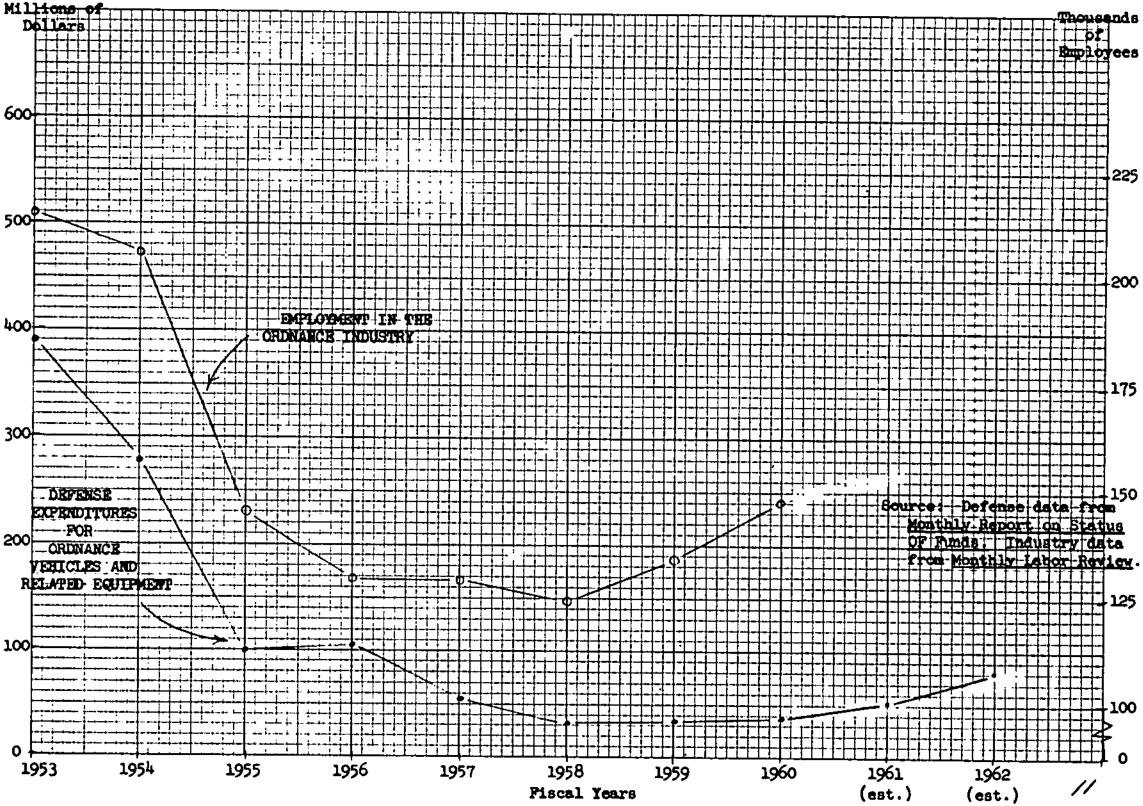
AVERAGE WEEKLY HOURS AND EARNINGS OF PRODUCTION WORKERS - "AIRCRAFT AND PARTS" INDUSTRY



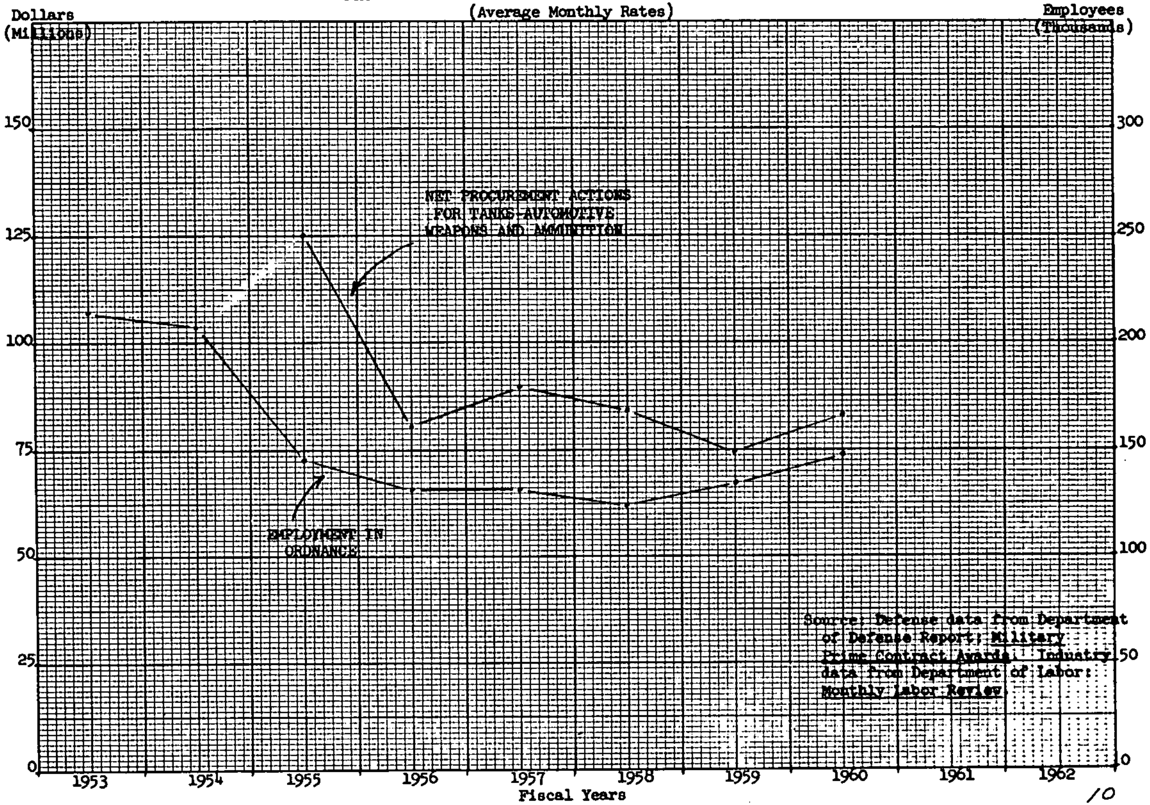
EMPLOYMENT IN THE "ORDNANCE AND ACCESSORIES" INDUSTRY



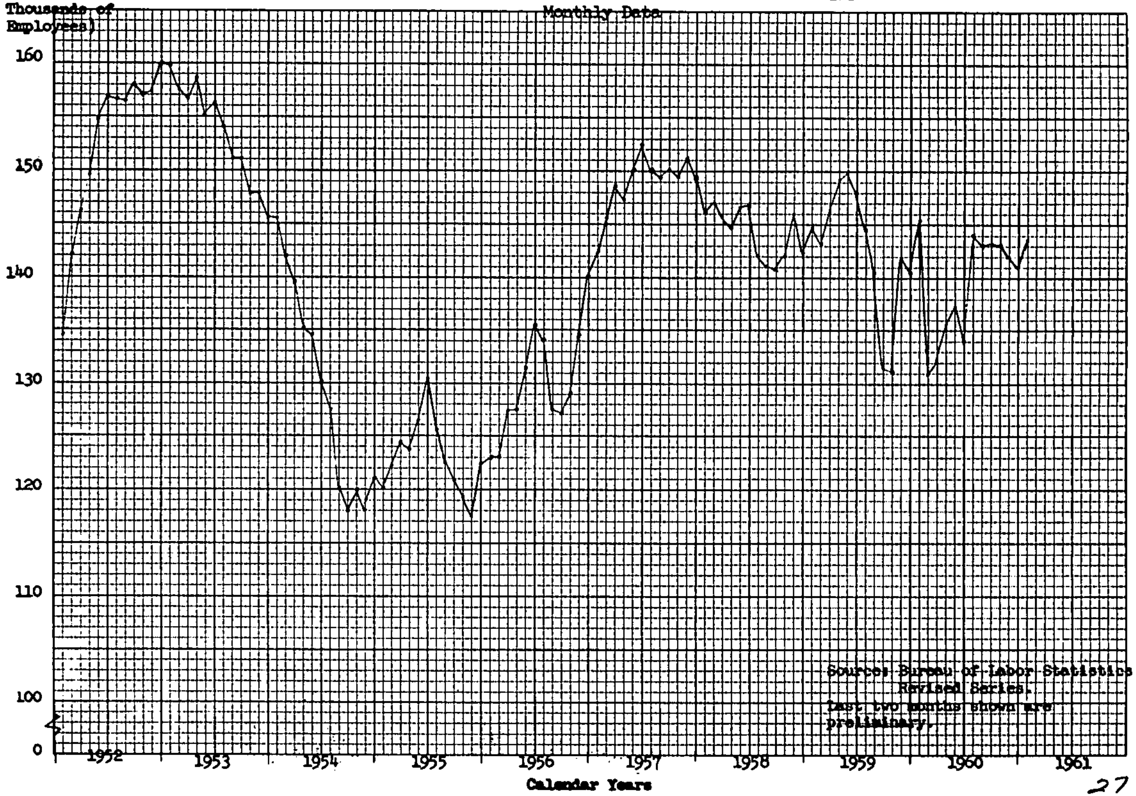
AVERAGE MONTHLY DEFENSE EXPENDITURES FOR ORDNANCE COMPARED WITH AVERAGE MONTHLY EMPLOYMENT IN THE ORDNANCE INDUSTRY



DoD NET PROCUREMENT ACTIONS FOR TANKS-AUTOMOTIVE, WEAPONS AND AMMUNITION
COMPARED WITH EMPLOYMENT IN THE ORDNANCE INDUSTRY
(Average Monthly Rates)

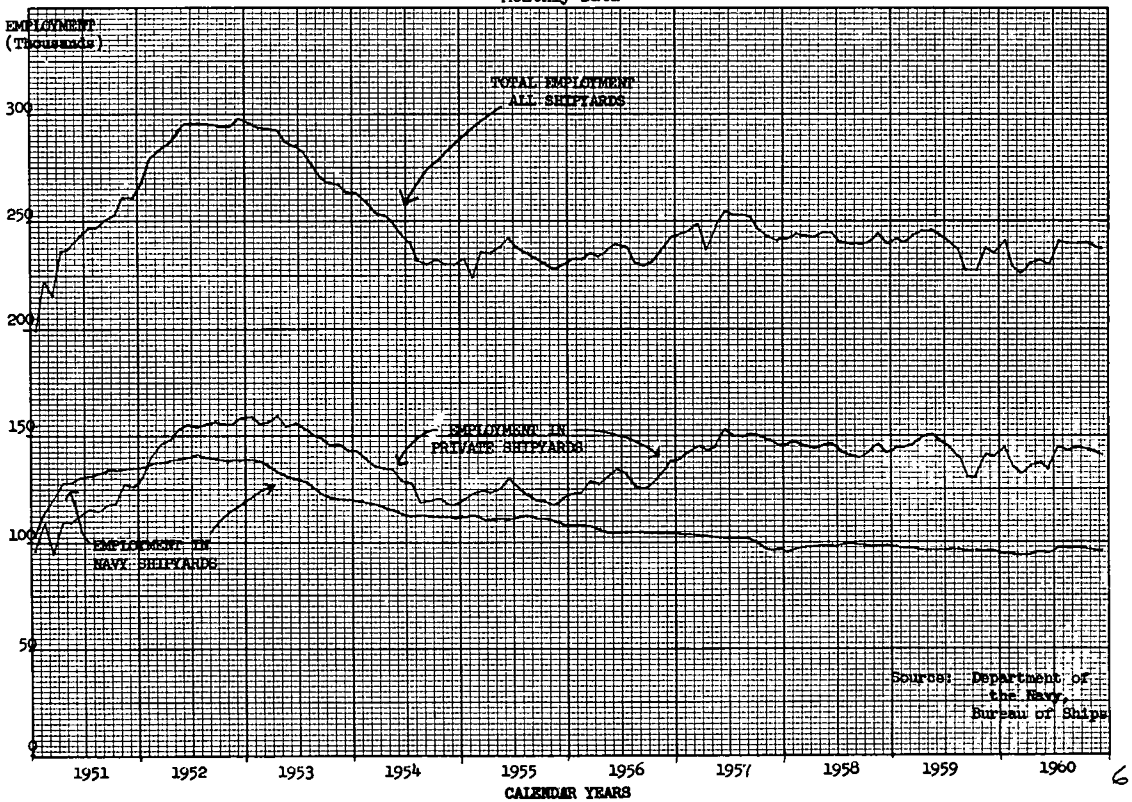


EMPLOYMENT IN THE "SHIP AND BOAT BUILDING AND REPAIR" INDUSTRY

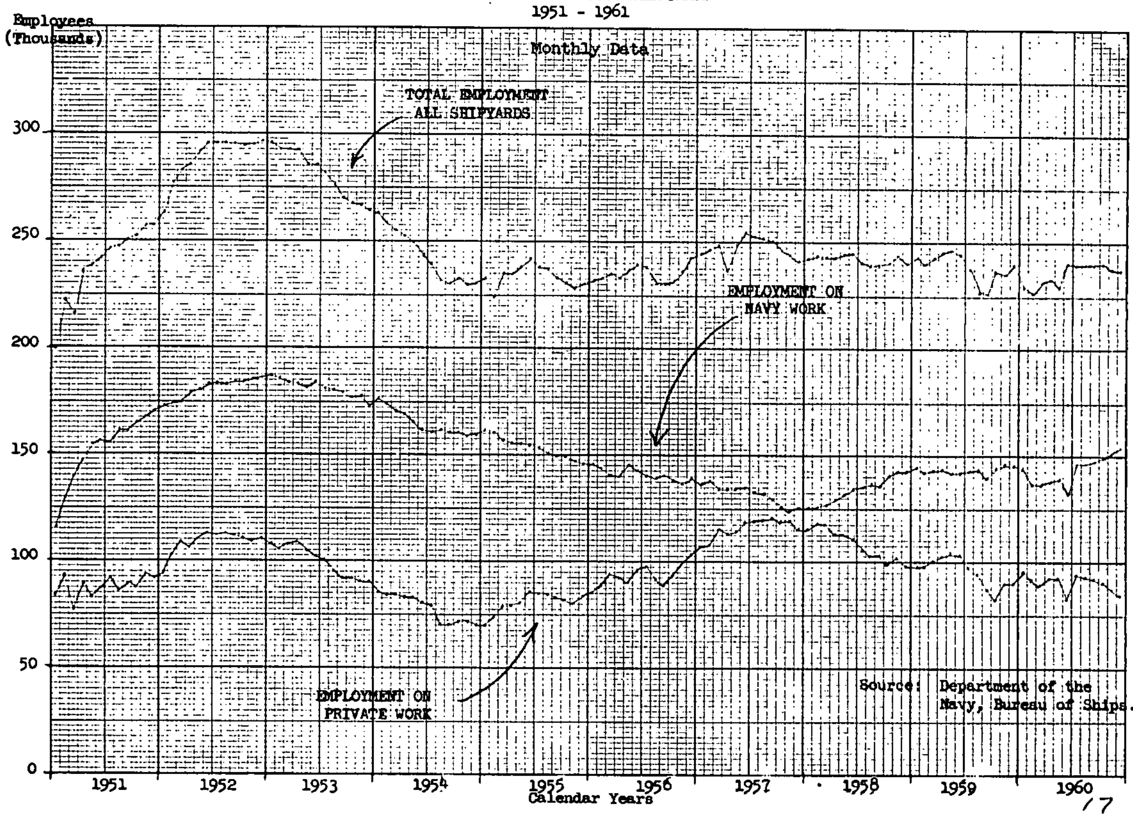


27

EMPLOYMENT IN U.S. PRIVATE AND NAVY SHIPYARDS
Monthly Data

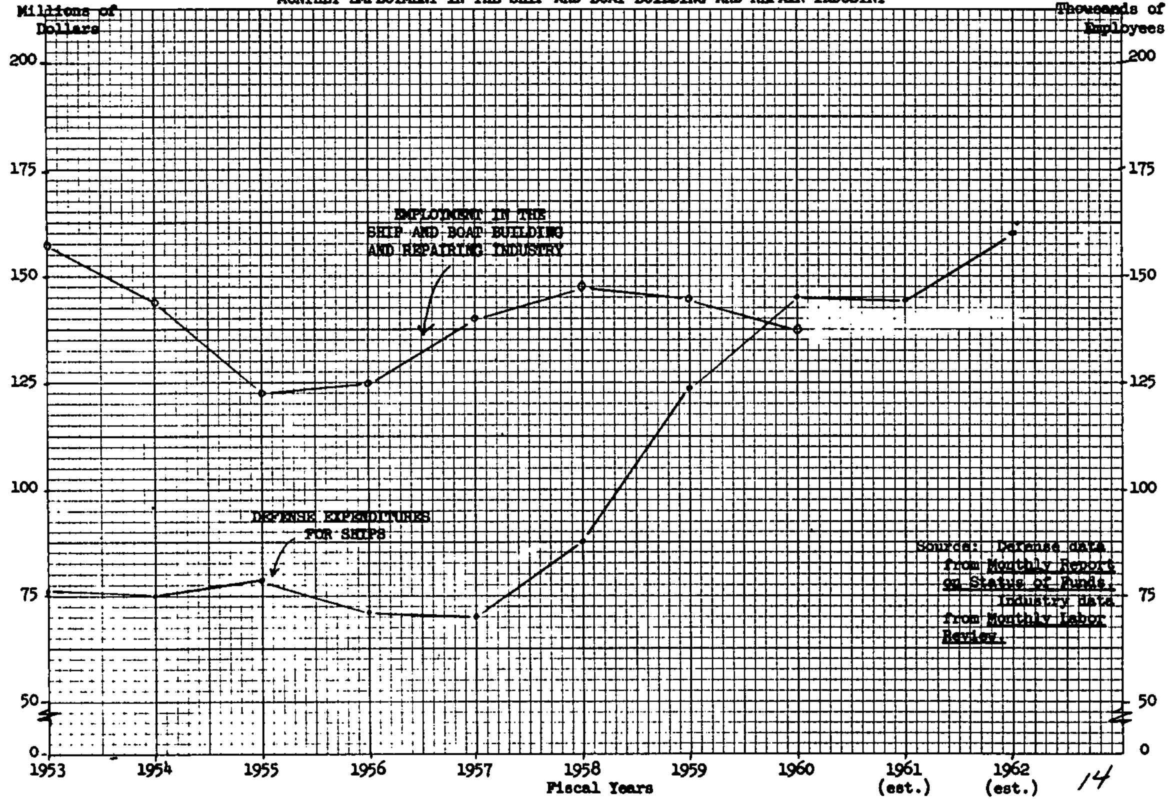


EMPLOYMENT IN U.S. SHIPYARDS
1951 - 1961

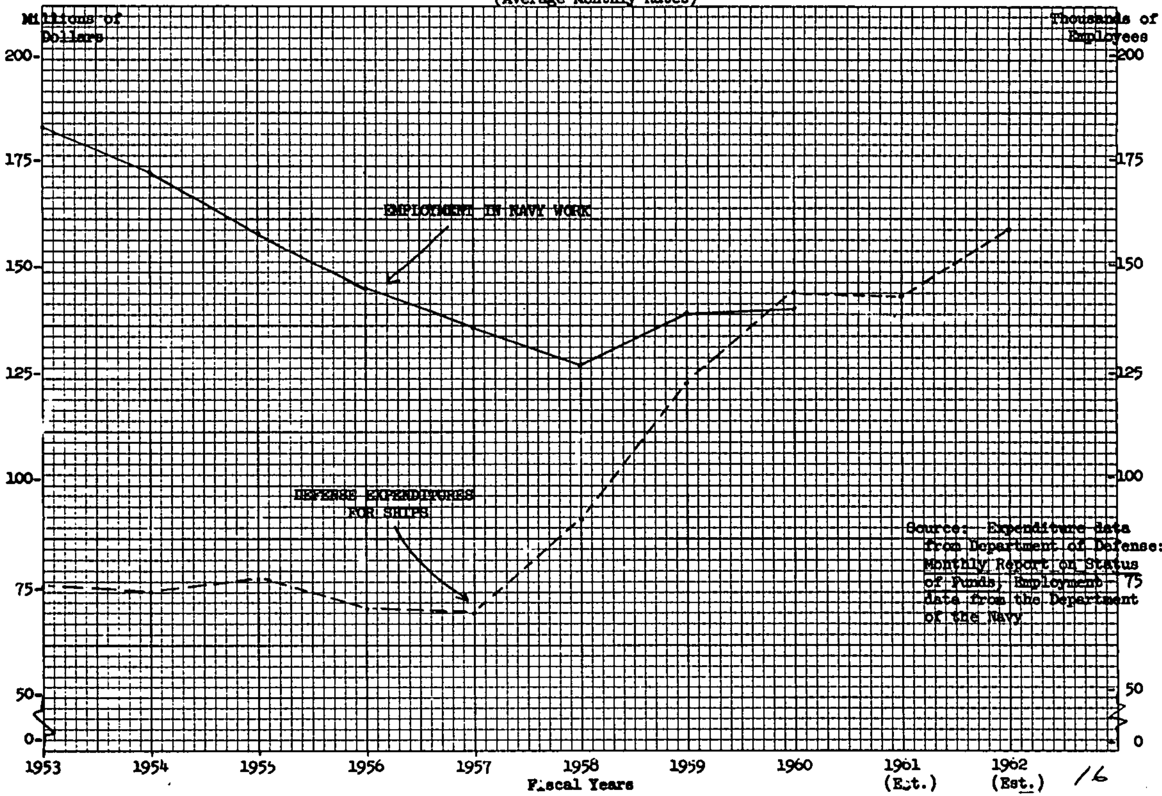


17

AVERAGE MONTHLY DEFENSE EXPENDITURES FOR SHIPS COMPARED WITH AVERAGE MONTHLY EMPLOYMENT IN THE SHIP AND BOAT BUILDING AND REPAIR INDUSTRY



DEPARTMENT OF DEFENSE NET EXPENDITURES FOR SHIPS COMPARED WITH
U.S. SHIPYARD EMPLOYMENT ASSOCIATED WITH NAVY WORK
(Average Monthly Rates)



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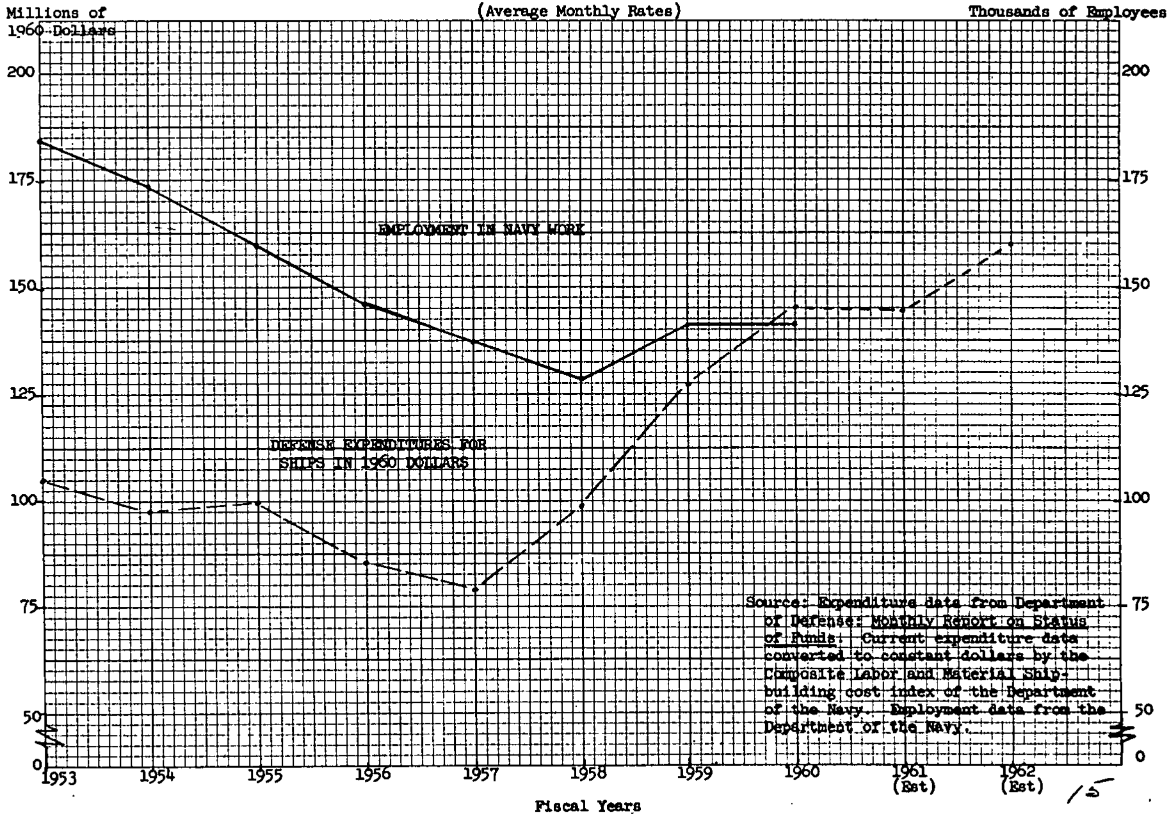
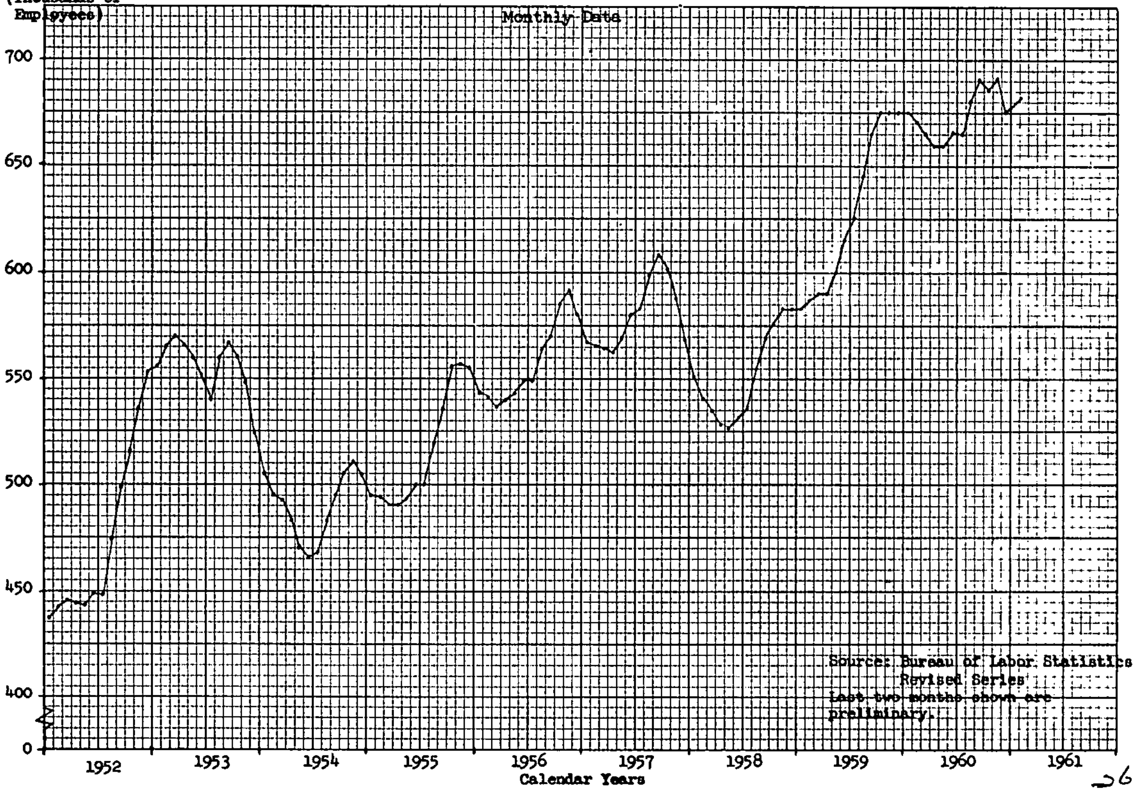
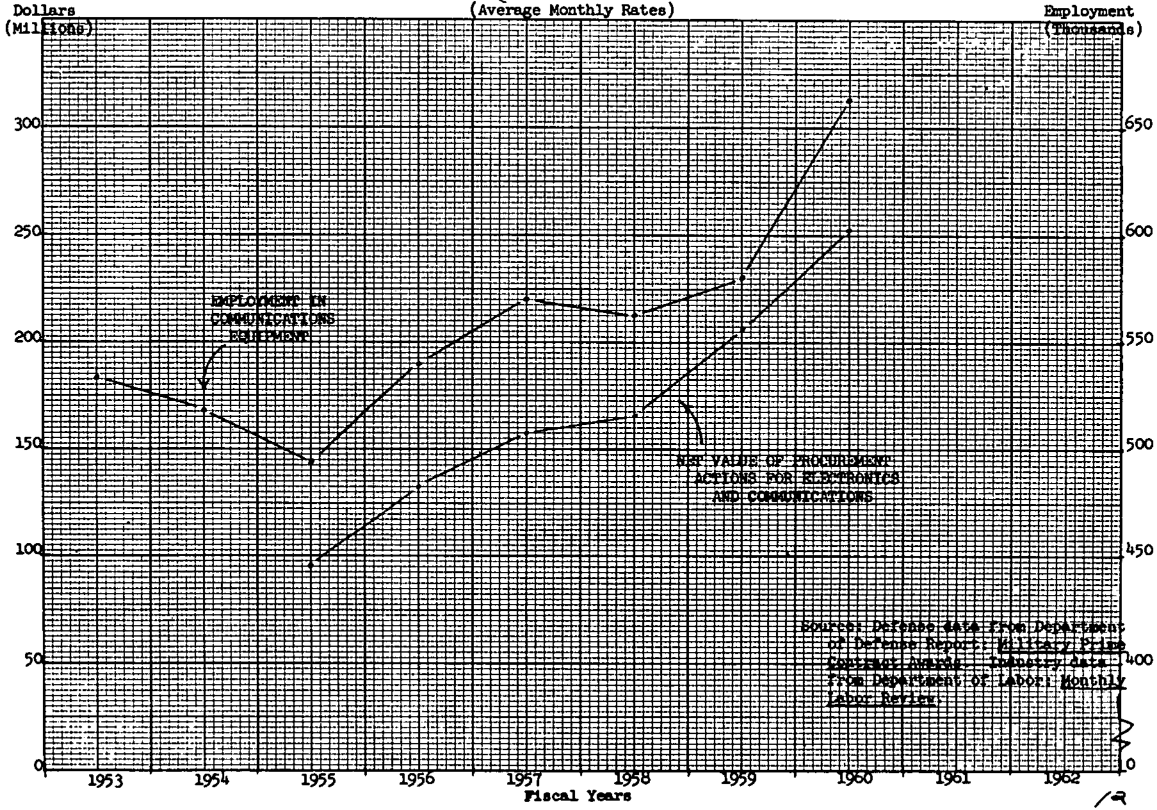
DEPARTMENT OF DEFENSE NET EXPENDITURES FOR SHIPS IN CONSTANT DOLLARS, COMPARED WITH U.S. SHIPYARD EMPLOYMENT ASSOCIATED WITH NAVY WORK
(Average Monthly Rates)

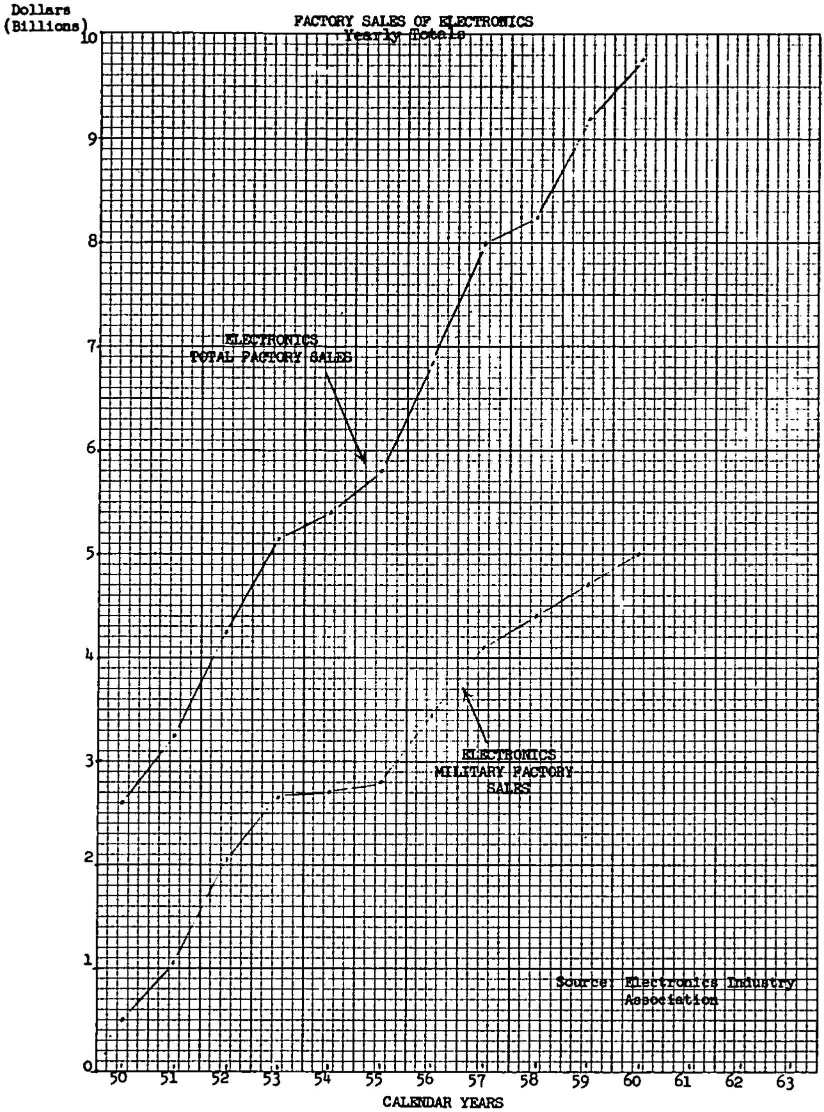


EMPLOYMENT IN THE "COMMUNICATIONS EQUIPMENT" INDUSTRY



NET VALUE OF MILITARY PROCUREMENT ACTIONS FOR ELECTRONICS AND COMMUNICATIONS
COMPARED WITH EMPLOYMENT IN THE COMMUNICATIONS EQUIPMENT INDUSTRY
(Average Monthly Rates)




Dollars
(Billions)
FACTORY SALES OF ELECTRONICS
Yearly Totals
ELECTRONICS
TOTAL FACTORY SALES
ELECTRONICS
MILITARY FACTORY
SALES
Source: Electronics Industry
Association
0
1
2
3
4
5
6
7
8
9
10
50
51
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63
CALENDAR YEARS

SUMMARY OF DEFENSE DEPARTMENT BUDGET

TABLE 1.

(Millions of Dollars)

	New obligational authority			Direct obligations			Net expenditures		
	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962
1. Eisenhower Budget (FY 1962 Budget Document)	40,627.9	41,308.1	41,840.3	40,225.1	44,050.9	43,422.9	41,214.8	41,500.0	42,910.0
a. Effect of actions taken prior to 1/20/61 and underestimate	-	-	-	-	b 150.0	-	-	c 743.4	c 190.0
b. FY 1961 supplementals proposed for later transmission a/	-	63.0	-	-	63.0	-	-	18.0	45.0
2. Adjusted Budget 1/20/61	40,627.9	41,371.1	41,840.3	40,225.1	44,263.9	43,422.9	41,214.8	42,261.4	43,145.0
c. Effect of actions taken after 1/20/61 to accelerate FY 1961	-	-	-	-	d 154.0	d -133.6	-	214.1	5.0
3. Adjusted Budget with accelerations	40,627.9	41,371.1	41,840.3	40,225.1	44,417.9	43,289.3	41,214.8	42,475.5	43,150.0
d. Effect of President Kennedy's Budget message	-	-	1,954.0	-	690.2	1,447.7	-	24.5	650.0
4. Budget proposed by President Kennedy	40,627.9	41,371.1	43,794.3	40,225.1	45,108.1	44,737.0	41,214.8	42,500.0	43,800.0

a/ Underestimate of Retired Pay ($15.0) and CONSTELLATION fire damage ($48.0).
b/ Underestimate of rate of obligation of funds.
c/ Underestimate of rate of expenditure of funds.
d/ Acceleration of approved procurement and construction actions in order to strengthen the military forces and stimulate the recovery.

28 March 1961

Department of Defense

TABLE 2.

NEW OBLIGATIONAL AUTHORITY

FY 1962

(Millions of Dollars)

	Eisenhower Budget	New proposals	Kennedy Budget
MILITARY PERSONNEL	a 12,416	68	a 12,484
Active Forces	10,879	43	10,922
Reserve Forces	611	-	611
Retired Pay	926	25	951
OPERATION AND MAINTENANCE	10,842	198	11,040
PROCUREMENT	13,378	1,591	14,969
Aircraft	4,896	166	5,062
Missiles	3,816	146	3,962
Ships	1,825	1,090	2,915
Ordnance, Vehicles & Related Equipment	1,123	20	1,143
Electronics and Communications	1,102	99	1,201
Other	616	69	685
RESEARCH, DEVELOPMENT, TEST & EVALUATION	4,349	376	4,725
MILITARY CONSTRUCTION	985	41	1,026
Active Forces	935	41	976
Reserve Forces	50	-	50
REVOLVING AND MANAGEMENT FUNDS	20	-	20
TOTAL - NEW OBLIGATIONAL AVAILABILITY	41,990	2,274	44,264
Transfers from Working Capital Funds	-150	-320	-470
TOTAL - NEW OBLIGATIONAL AUTHORITY	41,840	1,954	43,794

a/ New Obligational Availability, including transfers of prior year balances.

28 March 1961

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Department of Defense

TABLE 3.

NEW OBLIGATIONAL AUTHORITY BY SERVICE

FY 1962

(Millions of Dollars)

	Eisenhower Budget	New proposals	Kennedy Budget
Department of the Army			
New Obligational Availability	10,530	265	10,796
Transfers from Working Capital Funds	-125	-215	-340
New Obligational Authority	10,405	50	10,456
Department of the Navy			
New Obligational Availability	12,237	1,551	13,788
Transfers from Working Capital Funds	-	-66	-66
New Obligational Authority	12,237	1,485	13,722
Department of the Air Force			
New Obligational Availability	17,881	412	18,293
Transfers from Working Capital Funds	-25	-39	-64
New Obligational Authority	17,856	373	18,229
Office of the Secretary of Defense			
New Obligational Availability and New Obligational Authority	1,341	46	1,387
TOTAL, DEPARTMENT OF DEFENSE			
New Obligational Availability	41,990	2,274	44,264
Transfers from Working Capital Funds	-150	-320	-470
New Obligational Authority	41,840	1,954	43,794

28 March 1961

Department of Defense

TABLE 4.

NEW OBLIGATIONAL AUTHORITY, DIRECT OBLIGATIONS AND EXPENDITURES

Fiscal Years 1960-1962

(Millions of Dollars)

	New Obligational Authority			Direct Obligations			Expenditures		
	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962
Military Functions									
Military Personnel	12,026	12,236	12,484	11,934	12,218	12,484	11,738	12,253	12,456
Active Forces	[a]10,637	[a]10,770	[a]10,922	10,582	10,768	10,922	10,390	10,808	10,893
Reserve Forces	674	677	611	659	660	611	654	660	614
Retired Pay	715	790	951	693	790	951	694	785	949
Operation and Maintenance	10,317	10,714	11,040	10,243	10,728	11,040	10,223	10,438	10,803
Procurement	13,105	13,501	14,969	12,732	16,134	15,286	14,312	14,311	14,862
Aircraft	6,124	5,293	5,062	5,397	6,786	5,594	6,487	6,019	6,104
Missiles	3,240	3,520	3,962	3,474	4,107	4,014	3,790	4,157	4,175
Ships	1,140	2,294	2,915	1,473	2,461	2,551	1,744	1,727	1,921
Other	2,602	2,394	3,029	2,389	2,780	3,127	2,292	2,409	2,662
Research, Development, Test, and Evaluation	4,216	4,255	4,725	3,967	4,673	4,747	3,732	4,276	4,672
Military Construction	1,364	1,000	1,026	1,350	1,359	1,179	1,626	1,535	1,247
Active Forces	1,291	945	976	1,294	1,282	1,121	1,569	1,473	1,178
Reserve Forces	73	55	50	56	77	58	56	62	69
Revolving and Management Funds	30	30	20	-	-	-	-416	-313	-239
Sub-total	41,058	41,737	44,264	40,225	45,112	44,736	41,215	42,500	43,800
Available by transfer of prior year balances	-430	-366	-470						
TOTAL, MILITARY FUNCTIONS	40,628	41,371	43,794	40,225	45,112	44,736	41,215	42,500	43,800

NOTES: (1) Includes effect of anticipated FY 1961 supplemental appropriations proposed for later transmission: Retired Pay, DOD, $15 million; and Shipbuilding and Conversion, Navy, $48 million.

(2) Data are adjusted to reflect comparability with FY 1962 appropriation structure.

a/ New obligational availability, including transfers of prior year balances.

28 March 1961

Department of Defense

TABLE 5.

NEW OBLIGATIONAL AUTHORITY, DIRECT OBLIGATIONS AND EXPENDITURES

Fiscal Years 1960 - 1962

	New Obligational Authority			Direct Obligations			Expenditures		
	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962
Department of the Army	9,970	10,133	10,796	9,867	10,398	10,836	9,392	9,877	10,305
Department of the Navy	11,369	12,514	13,788	11,727	13,341	13,560	11,642	11,886	12,496
Department of the Air Force	18,546	17,895	18,293	17,662	20,105	18,972	19,168	19,563	19,512
Office of the Secretary of Defense	1,173	1,195	1,387	969	1,268	1,367	1,013	1,173	1,486
Sub-total	41,058	41,737	44,264	40,225	45,112	44,736	41,215	42,500	43,800
Available by transfer of prior year balances:	-430	-366	-470						
Army	-281	-260	-340						
Navy	-99	-76	-66						
Air Force	-50	-30	-64						
TOTAL, MILITARY FUNCTIONS	40,628	41,371	43,794	40,225	45,112	44,736	41,215	42,500	43,800

NOTE: Includes effect of anticipated FY 1961 supplemental appropriations proposed for later transmission: Retired Pay, DOD, $15 million; and Shipbuilding and Conversion, Navy, $48 million.

28 March 1961

Department of Defense

TABLE 6.

ORDER OF MAGNITUDE DATA ON COMPARATIVE NEW OBLIGATIONAL AUTHORITY BY FUNCTIONAL TITLE
AS IF FY 1961 BUDGET STRUCTURE HAD BEEN ADOPTED CIRCA 1948

FY 1953 - 1962

(Millions of Dollars)

	FY 1953	FY 1954	FY 1955	FY 1956	FY 1957	FY 1958	FY 1959	FY 1960	FY 1961	FY 1962
MILITARY PERSONNEL	12,502	11,968	11,442	11,534	11,539	11,572	11,993	12,026	12,236	12,484
Active Forces	11,921	11,266	10,650	10,526	10,411	10,398	10,709	10,637	10,770	10,922
Reserve Forces	224	315	369	512	613	607	644	674	677	611
Retired Pay	357	387	424	495	515	567	640	715	790	951
OPERATION AND MAINTENANCE	10,258	9,462	8,276	8,768	9,734	10,221	10,187	10,317	10,714	11,040
PROCUREMENT	21,117	10,588	7,420	9,795	11,294	10,983	14,304	13,105	13,501	14,969
Aircraft	13,948	5,041	4,922	6,923	6,559	5,945	6,167	6,124	5,293	5,062
Missiles	685	569	234	764	2,135	2,090	3,966	3,240	3,520	3,962
Ships	623	759	1,150	1,274	1,335	1,723	1,943	1,140	2,294	2,915
Astronautics	-	-	-	-	-	-	-	-	-	-
Ordnance, Vehicles, & Related Equip.	3,849	2,990	527	405	247	90	545	703	1,041	1,143
Electronics and Communications	591	395	327	215	469	549	982	1,179	963	1,201
Other Equipment	1,421	835	260	214	549	586	701	720	391	685
RESEARCH, DEVELOP., TEST, AND EVALUATION	2,426	2,165	1,708	1,828	2,185	2,345	3,777	4,216	4,255	4,725
MILITARY CONSTRUCTION	2,335	308	882	2,012	1,915	2,085	1,385	1,364	1,000	1,026
REVOLVING AND MANAGEMENT FUNDS	360	100	1,119	-	75	130	57	30	30	20
TOTAL - NEW OBLIGATIONAL AVAILABILITY	48,997	34,590	30,847	33,937	36,742	37,337	41,703	41,058	41,737	44,264
Transfers from prior year balances	-80	-	-60	-750	-487	-590	-535	-430	-366	-470
TOTAL - NEW OBLIGATIONAL AUTHORITY	48,916	34,590	30,787	33,187	36,255	36,747	41,168	40,628	41,371	43,794

NOTE: Amounts include estimated comparability adjustments not supportable by accounting records.

OASD Comptroller
FAD-396
28 March 1961
Replaces FAD-396
dated 16 Jan. 1961 (R)

Department of Defense

TABLE 7.

ORDER OF MAGNITUDE DATA ON COMPARATIVE EXPENDITURES BY FUNCTIONAL TITLE
AS IF FY 1961 BUDGET STRUCTURE HAD BEEN ADOPTED CIRCA 1948

FY 1953 - 1962

(Millions of Dollars)

	FY 1953	FY 1954	FY 1955	FY 1956	FY 1957	FY 1958	FY 1959	FY 1960	FY 1961	FY 1962
MILITARY PERSONNEL	12,179	11,643	11,403	11,582	11,409	11,611	11,801	11,738	12,253	12,456
Active Forces	11,556	10,963	10,643	10,665	10,384	10,441	10,545	10,390	10,808	10,893
Reserve Forces	266	293	341	439	514	608	615	654	660	614
Retired Pay	357	386	419	477	511	562	641	694	785	949
OPERATION AND MAINTENANCE	10,028	9,162	7,931	8,400	9,487	9,761	10,378	10,223	10,438	10,803
PROCUREMENT	17,297	15,957	12,838	12,227	13,488	14,083	14,409	14,312	14,311	14,862
Aircraft	8,189	9,080	8,804	7,835	8,647	8,793	7,730	6,487	6,019	6,104
Missiles	245	417	604	1,005	1,855	2,434	3,337	3,790	4,157	4,175
Ships	920	905	944	858	842	1,105	1,491	1,744	1,727	1,921
Astronautics	-	-	-	-	-	-	-	-	-	-
Ordnance, Vehicles, & Related Equip.	4,686	3,334	1,191	1,260	674	365	399	443	628	979
Electronics and Communications	937	700	441	660	704	663	720	1,093	1,082	1,096
Other Equipment	2,320	1,521	854	608	767	723	730	755	699	587
RESEARCH, DEVELOP., TEST, AND EVALUATION	2,148	2,187	2,261	2,101	2,406	2,504	2,866	3,732	4,276	4,672
MILITARY CONSTRUCTION	1,937	1,744	1,715	2,079	1,968	1,753	1,948	1,626	1,535	1,247
REVOLVING AND MANAGEMENT FUNDS	22	-210	-610	-685	-320	-651	-169	-416	-313	-239
TOTAL - SF 133 BASIS	43,613	40,484	35,538	35,705	38,439	39,062	41,233	41,215	42,500	43,800
Adjustment to Budget basis	-2	-148	-6	86	-	-	-	-	-	-
TOTAL - BUDGET BASIS	43,611	40,336	35,532	35,791	38,439	39,062	41,233	41,215	42,500	43,800

NOTE: Amounts include estimated comparability adjustments not supportable by accounting records.

OASD Comptroller
FAD-397
28 March 1961
Replaces FAD-397
dated 16 Jan. 1961

FINANCIAL PLAN FOR FY 1961

Obligation Plan for General and Special Fund Appropriations

Thousands of Dollars

Appropriation title	Resources available for obligation in FY 1961: Unobligated balance brought forward	Resources available: FY 1961 appropriations	Resources available: Proposed supplementals	Resources available: Transfers	Anticipated reimbursements based on orders to be received in FY 1961: From FY 1961 MAP .002 orders including adjustments	Anticipated reimbursements: From orders subject to automatic apportionment	Anticipated reimbursements: From all other sources	Anticipated reimbursements: Total anticipated reimbursements	Recovery of prior year obligations	Total obligational availability (cols 2+3+4+5+9+10)	Planned apportionment program: Planned obligations: For service account obligations (direct)	Planned obligations: Obligations for customer orders	Planned obligations: Total (cols 12+13)	Planned for commitment in FY 1961 (to be unobligated on 30 Jun '61)	Total planned apportionment program (cols 14+15)	Unobligated balance expiring for obligation 30 Jun '61	Unobligated balance available in FY 1962: Planned for commitment in FY 1961 (to be unobligated on 30 Jun '61)	Reserved for carry-over into FY 1962: For completion of FY 1961 and prior year programs	Reserved for carry-over: Available for future requirements	Total unobligated balance available in FY 1962
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
MILITARY PERSONNEL																				
Military Personnel, Army	-	3,247,548	7,000	260,000	-	-	173,000	173,000	-	3,687,548	3,514,548	173,000	3,687,548	-	3,687,548	-	-	-	-	-
Military Personnel, Navy	-	2,508,244	15,000	75,000	-	-	32,756	32,756	-	2,631,000	2,598,244	32,756	2,631,000	-	2,631,000	-	-	-	-	-
Military Personnel, Marine Corps	5	606,746	-	500	-5	-	6,500	6,495	-	613,746	606,500	6,500	613,000	-	613,000	746	-	-	-	-
Military Personnel, Air Force	-	4,019,676	-	30,000	-	-	31,000	31,000	-	4,080,676	4,048,784	31,000	4,079,784	-	4,079,784	892	-	-	-	-
Reserve Personnel, Army	-	233,998	-	-	-	-	1,000	1,000	-	234,998	219,598	1,000	220,598	-	220,598	14,400	-	-	-	-
Reserve Personnel, Navy	-	87,584	-	-	-	-	-	-	-	87,584	85,584	-	85,584	-	85,584	2,000	-	-	-	-
Reserve Personnel, Marine Corps	-	24,831	-	-	-	-	280	280	-	25,111	24,831	280	25,111	-	25,111	-	-	-	-	-
Reserve Personnel, Air Force	-	54,000	-	-	-	-	25	25	-	54,025	53,212	25	53,237	-	53,237	788	-	-	-	-
National Guard Personnel, Army	-	230,277	-	-	-	-	1,100	1,100	-	231,377	230,277	1,100	231,377	-	231,377	-	-	-	-	-
National Guard Personnel, Air Force	-	46,000	-	-	-	-	128	128	-	46,128	46,000	128	46,128	-	46,128	-	-	-	-	-
Retired Pay, Department of Defense	-	775,000	15,000	-	-	-	-	-	-	790,00C	790,000	-	790,000	-	790,000	-	-	-	-	-
TOTAL - MILITARY PERSONNEL	5	11,833,904	37,000	365,500	-5	-	245,789	245,784	-	12,482,193	12,217,578	245,789	12,463,367	-	12,463,367	18,826	-	-	-	-
OPERATION AND MAINTENANCE																				
Operation and Maintenance, Army	74,243	3,120,022	88,500	-3,950	60,200	-	427,000	487,200	-	3,766,015	3,204,572	492,000	3,696,572	-	3,696,572	-	-	69,443	-	69,443
Operation and Maintenance, Navy	16,919	2,518,897	78,400	-671	-14,213	81,341	75,954	143,081	-	2,756,626	2,596,626	160,000	2,756,626	-	2,756,626	-	-	-	-	-
Operation and Maintenance, Marine Corps	4,366	174,686	2,039	-	-3,792	12,700	2,726	11,634	-	192,725	176,725	16,000	192,725	-	192,725	-	-	-	-	-
Operation and Maintenance, Air Force	4,755	4,243,398	72,000	-811	32,000	-	246,245	278,245	-	4,597,587	4,314,587	283,000	4,597,587	-	4,597,587	-	-	-	-	-
Operation and Maintenance, Army National Guard	-	162,001	4,315	-	-	-	60	60	-	166,376	166,316	60	166,376	-	166,376	-	-	-	-	-
Operation and Maintenance, Air National Guard	-	187,291	2,190	-	-	-	949	949	-	190,430	189,481	949	190,430	-	190,430	-	-	-	-	-
Promotion of Rifle Practice, Army	-	501	-	-	-	-	-	-	-	501	501	-	501	-	501	-	-	-	-	-
Operation & Maintenance, Alaska Communication System, Army	-	7,000	230	-	-	-	-	-	-	7,230	7,230	-	7,230	-	7,230	-	-	-	-	-
Salaries and Expenses, Secretary of Defense	-	18,975	875	-	-	-	-	-	-	19,850	19,850	-	19,850	-	19,850	-	-	-	-	-
Claims, Department of Defense	-	16,575	6,000	-	-	-	-	-	-	22,575	22,575	-	22,575	-	22,575	-	-	-	-	-
Contingencies, Department of Defense	-	15,000	-	-	-	-	-	-	-	15,000	15,000	-	15,000	-	15,000	-	-	-	-	-
Salaries and Expenses, Court of Military Appeals, DOD	-	425	-	-	-	-	-	-	-	425	425	-	425	-	425	-	-	-	-	-
TOTAL - OPERATION AND MAINTENANCE	100,282	10,464,771	254,549	-5,432	74,194	94,041	752,934	921,169	-	11,735,340	10,713,888	952,009	11,665,897	-	11,665,897	-	-	69,443	-	69,443
PROCUREMENT																				
Procurement of Equipment and Missiles, Army	649,229	1,495,352	-	-3,900	233,000	-	249,000	482,000	-	2,622,681	1,633,452	701,333	2,334,785	242,896	2,577,681	-	242,896	-	45,000	287,896
Procurement of Aircraft and Missiles, Navy	-	2,141,760	-	184,355	33,000	-	20,000	53,000	-	2,379,115	1,776,300	48,000	1,824,300	515,655	2,339,955	-	515,655	9,160	30,000	554,815
Shipbuilding and Conversion, Navy	805,815	2,316,360	48,000	-70,770	40,917	-	4,000	44,917	-	3,144,322	2,486,100	67,000	2,553,100	298,295	2,851,395	-	298,295	292,927	-	591,222
Other Procurement, Navy	-	420,980	-	81,500	93,919	-	29,400	123,319	-	625,799	493,600	96,000	589,600	15,914	605,514	-	15,914	20,285	-	36,199
Procurement, Marine Corps	116,924	91,180	-	-	-3,395	-	-	-3,395	-	204,709	142,100	2,370	144,470	60,239	204,709	-	60,239	-	-	60,239
Aircraft Procurement, Air Force	1,558,441	3,251,449	-	484,200	117,500	-	64,473	181,973	-	5,476,063	4,227,700	127,500	4,355,200	563,000	4,918,200	-	563,000	424,663	133,200	1,120,863
Airlift Modernization, Air Force	-	310,788	-	-	4,200	-	-	4,200	-	314,988	227,800	4,200	232,000	34,000	266,000	-	34,000	12,300	36,688	82,988
Missile Procurement, Air Force	378,302	2,615,120	-	698,700	115,017	-	-	115,017	-	3,807,139	3,017,000	154,100	3,171,100	612,022	3,783,122	-	612,022	24,017	-	636,039
Other Procurement, Air Force	399,938	877,171	-	62,755	53,000	-	35,000	88,000	-	1,427,864	1,023,000	78,000	1,101,000	260,764	1,361,764	-	260,764	56,100	10,000	326,864
Aircraft and Related Procurement, Navy	1,426,767	-	-	-274,115	10	-	505	515	-	1,153,167	755,800	20,700	776,500	376,667	1,153,167	-	376,667	-	-	376,667
Procurement of Ordnance and Ammunition, Navy	105,816	-	-	-2,400	1,966	-	1,930	3,896	-	107,312	39,000	40,000	79,000	28,312	107,312	-	28,312	-	-	28,312
Aircraft, Missiles, and Related Procurement, Air Force	1,420,074	-	-	-1,354,200	25,000	-	-	25,000	150,000	240,874	215,000	-	215,000	25,874	240,874	-	25,874	-	-	25,874
Procurement other than Aircraft and Missiles, Air Force	231,264	-	-	-76,055	-25,000	-	-4,578	-29,578	-	125,631	97,000	-	97,000	28,631	125,631	-	28,631	-	-	28,631
TOTAL - PROCUREMENT	7,092,570	13,520,160	48,000	-269,930	689,134	-	399,730	1,088,864	150,000	21,629,664	16,133,852	1,339,203	17,473,055	3,062,269	20,535,324	-	3,062,269	839,452	254,888	4,156,609

See footnotes on page 2.

OASD Comptroller
FAD-378
28 March 1961
Replaces FAD-378
dated 16 Jan. 1961

66841 O - 61 (Face p. 654) No. 1

Department of Defense

FY 1961

OBLIGATIONS

FINANCIAL PLAN FOR FY 1961

Obligation Plan for General and Special Fund Appropriations

Thousands of Dollars

Appropriation title	Resources available for obligation in FY 1961: Unobligated balance brought forward	FY 1961 appropriations	Proposed supplementals	Transfers	Anticipated reimbursements based on orders to be received in FY 1961: From FY 1961 MAP .002 orders including adjustments	From orders subject to automatic apportionment	From all other sources	Total anticipated reimbursements	Recovery of prior year obligations	Total obligational availability (cols 2+3+4+5+9+10)	Planned apportionment program: Planned obligations: For service account obligations (direct)	Obligations for customer orders	Total (cols 12+13)	Planned for commitment in FY 1961 (to be unobligated on 30 Jun '61)	Total planned apportionment program (cols 14+15)	Unobligated balance expiring for obligation 30 Jun '61	Unobligated balance available in FY 1962: Planned for commitment in FY 1961 (to be unobligated on 30 Jun '61)	Reserved for carry-over into FY 1962: For completion of FY 1961 and prior year programs	Available for future requirements	Total unobligated balance available in FY 1962
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
RESEARCH, DEVELOPMENT, TEST, AND EVALUATION																				
Research, Development, Test, and Evaluation, Army	101,450	1,041,286	12,000	49,192	-	-	14,000	14,000	-	1,217,928	1,166,192	14,000	1,180,192	37,736	1,217,928	-	37,736	-	-	37,736
Research, Development, Test, and Evaluation, Navy	82,859	1,218,624	-	100,355	-	39,500	1,000	40,500	-	1,442,338	1,369,660	40,500	1,410,160	22,178	1,432,338	-	22,178	-	10,000	32,178
Research, Development, Test, and Evaluation, Air Force	233,651	1,552,863	-	184,550	283	-	165,317	165,600	-	2,136,664	1,761,000	165,600	1,926,600	95,564	2,022,164	-	95,564	30,000	84,500	210,064
Salaries and Expenses, Advanced Research Projects Agency, DOD	122,741	215,000	-	-54,541	-	-	500	500	-	283,700	244,459	500	244,959	38,741	283,700	-	38,741	-	-	38,741
Emergency Fund, Department of Defense	-	150,000	-	-17,967	-	-	-	-	-	132,033	132,033	-	132,033	-	132,033	-	-	-	-	-
TOTAL - RESEARCH, DEVELOPMENT, TEST, AND EVALUATION	540,700	4,177,773	12,000	261,589	283	39,500	180,817	220,600	-	5,212,663	4,673,344	220,600	4,893,944	194,219	5,088,163	-	194,219	30,000	94,500	318,719
MILITARY CONSTRUCTION																				
Military Construction, Army	138,445	148,407	-	-	-	-	57,613	57,613	-	344,465	195,000	57,613	252,613	91,852	344,465	-	91,852	-	-	91,852
Military Construction, Navy	88,466	162,519	-	-	-	-	15,000	15,000	-	265,985	180,000	15,000	195,000	70,985	265,985	-	70,985	-	-	70,985
Military Construction, Air Force	619,114	609,501	-	-	-	-	5,500	5,500	-	1,234,115	861,200	5,500	866,700	367,415	1,234,115	-	367,415	-	-	367,415
Military Construction, Army Reserve	9,183	16,038	-	-	-	-	-	-	-	25,221	19,000	-	19,000	6,221	25,221	-	6,221	-	-	6,221
Military Construction, Naval Reserve	9,489	4,000	-	-	-	-	-	-	-	13,489	10,000	-	10,000	3,489	13,489	-	3,489	-	-	3,489
Military Construction, Air Force Reserve	1,363	4,000	-	-	-	-	-	-	-	5,363	5,000	-	5,000	363	5,363	-	363	-	-	363
Military Construction, Army National Guard	13,551	17,540	-	-	-	-	-	-	-	31,091	27,000	-	27,000	4,091	31,091	-	4,091	-	-	4,091
Military Construction, Air National Guard	5,030	13,850	-	-	-	-	-	-	-	18,880	16,000	-	16,000	2,530	18,530	-	2,530	-	350	2,880
Loran Stations, Department of Defense	-	19,000	-	-	-	-	-	-	-	19,000	19,000	-	19,000	-	19,000	-	-	-	-	-
Construction, Alaska Communication System, Army	458	-	-	-	-	-	-	-	-	458	21	-	21	-	21	-	-	-	437	437
Military Construction, ARPA, Department of Defense	19,363	(a)	-	5,541	-	-	-	-	-	24,904	24,904	-	24,904	-	24,904	-	-	-	-	-
TOTAL - MILITARY CONSTRUCTION	904,460	994,855	-	5,541	-	-	78,113	78,113	-	1,982,971	1,357,125	78,113	1,435,238	546,946	1,982,184	-	546,946	-	787	547,733
DEPARTMENT OF DEFENSE																				
Department of the Army	986,559	9,719,970	112,045	301,342	293,200	-	922,773	1,215,973	-	12,335,889	10,383,707	1,440,106	11,823,813	382,796	12,206,609	14,400	382,796	69,443	45,437	497,676
Department of the Navy	2,657,425	12,276,411	143,439	93,754	148,406	133,541	190,051	471,998	-	15,643,027	13,341,070	545,106	13,886,176	1,391,733	15,277,909	2,746	1,391,733	322,372	40,000	1,754,105
Department of the Air Force	4,851,931	17,785,107	74,190	29,139	322,000	-	544,059	866,059	150,000	23,756,427	20,102,764	850,002	20,952,766	1,990,163	22,942,929	1,680	1,990,163	547,080	264,738	2,801,981
Office of the Secretary of Defense	142,104	1,209,975	21,875	-66,967	-	-	500	500	-	1,307,487	1,268,246	500	1,268,746	38,741	1,307,487	-	38,741	-	-	38,741
TOTAL - DEPARTMENT OF DEFENSE (MILITARY FUNCTIONS)	8,638,018	40,991,463	b 351,549	357,268	763,606	133,541	1,657,383	2,554,530	150,000	c 53,042,830	45,095,787	2,835,714	47,931,501	3,803,433	51,734,934	18,826	3,803,433	938,895	350,175	5,092,503

a/ Transfer of up to $20,000,000 from Salaries and Expenses, Advanced Research Projects Agency is authorized.

b/ Excludes proposed $30,000,000 reappropriation transfer of unexpended balances from expired accounts to the revolving fund account "Acquisition, Rehabilitation and Rental of Wherry Act Housing."

c/ The total obligational availability is the sum of the amounts available to each individual appropriation account. Consequently, the totals of the appropriation groupings as well as the departmental and DOD totals are overstated by the "duplicate count" of reimbursements arising from intra-service and inter-service reimbursement transactions which in grand total, amount to approximately $1.0 billion.

Approved: ____________________
Assistant Secretary of Defense
(Comptroller)

OASD Comptroller
FAD-378
28 March 1961
Replaces FAD-378
dated 16 Jan. 1961

Department of Defense

FINANCIAL PLAN FOR FY 1962

Obligation Plan for General Fund Appropriations

FY 1962

OBLIGATIONS

Thousands of Dollars

Appropriation title	Status of unobligated balance brought forward: Available for completion of prior year programs	Status of unobligated balance brought forward: Available to finance FY 1962 programs	Resources available for obligation in FY 1962: Unobligated balance brought forward	Resources available for obligation in FY 1962: FY 1962 appropriations	Resources available for obligation in FY 1962: Proposed supplemental	Resources available for obligation in FY 1962: Transfers	Anticipated reimbursements based on orders to be received in FY 1962: From FY 1962 MAP .002 orders a/	Anticipated reimbursements based on orders to be received in FY 1962: From orders subject to automatic apportionment	Anticipated reimbursements based on orders to be received in FY 1962: From all other sources	Anticipated reimbursements based on orders to be received in FY 1962: Total anticipated reimbursements	Total obligational availability (cols 4+5+6+7+11)	Planned apportionment program: Planned obligations: For service account obligations (direct)	Planned apportionment program: Planned obligations: Obligations for customer orders	Planned apportionment program: Planned obligations: Total (Cols 13+14)	Planned apportionment program: Planned for commitment in FY 1962 (to be unobligated on 30 Jun '62)	Planned apportionment program: Total planned apportionment program (cols 15+16)	Unobligated balance available in FY 1963: Planned for commitment (to be unobligated on 30 Jun '62)	Unobligated balance available in FY 1963: Reserved for completion of FY 1962 and prior year programs	Unobligated balance available in FY 1963: Total available for completion of FY 1962 and prior year programs
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
MILITARY PERSONNEL																			
Military Personnel, Army	-	-	-	3,202,000	-	340,000	-	-	165,000	165,000	3,707,000	3,542,000	165,000	3,707,000	-	3,707,000	-	-	-
Military Personnel, Navy	-	-	-	2,600,000	-	55,000	-	-	30,000	30,000	2,685,000	2,655,000	30,000	2,685,000	-	2,685,000	-	-	-
Military Personnel, Marine Corps	-	-	-	617,000	-	11,000	-	-	5,500	5,500	633,500	628,000	5,500	633,500	-	633,500	-	-	-
Military Personnel, Air Force	-	-	-	4,033,000	-	64,000	-	-	28,000	28,000	4,125,000	4,097,000	28,000	4,125,000	-	4,125,000	-	-	-
Reserve Personnel, Army	-	-	-	199,000	-	-	-	-	800	800	199,800	199,000	800	199,800	-	199,800	-	-	-
Reserve Personnel, Navy	-	-	-	84,600	-	-	-	-	-	-	84,600	84,600	-	84,600	-	84,600	-	-	-
Reserve Personnel, Marine Corps	-	-	-	26,400	-	-	-	-	190	190	26,590	26,400	190	26,590	-	26,590	-	-	-
Reserve Personnel, Air Force	-	-	-	52,000	-	-	-	-	20	20	52,020	52,000	20	52,020	-	52,020	-	-	-
National Guard Personnel, Army	-	-	-	202,000	-	-	-	-	1,000	1,000	203,000	202,000	1,000	203,000	-	203,000	-	-	-
National Guard Personnel, Air Force	-	-	-	47,000	-	-	-	-	129	129	47,129	47,000	129	47,129	-	47,129	-	-	-
Retired Pay, Department of Defense	-	-	-	920,000	-	-	-	-	-	-	920,000	920,000	-	920,000	-	920,000	-	-	-
Proposed for later transmission:																			
Retired Pay, Department of Defense	-	-	-	-	31,000	-	-	-	-	-	31,000	31,000	-	31,000	-	31,000	-	-	-
TOTAL - MILITARY PERSONNEL	-	-	-	11,983,000	31,000	470,000	-	-	230,639	230,639	12,714,639	12,484,000	230,639	12,714,639	-	12,714,639	-	-	-
OPERATION AND MAINTENANCE																			
Operation and Maintenance, Army	69,443	-	69,443	3,322,000	-	-	-	-	440,600	440,600	3,832,043	3,322,000	477,000	3,799,000	-	3,799,000	-	33,043	33,043
Operation and Maintenance, Navy	-	-	-	2,718,000	-	-	-	80,000	59,000	139,000	2,857,000	2,718,000	139,000	2,857,000	-	2,857,000	-	-	-
Operation and Maintenance, Marine Corps	-	-	-	181,000	-	-	-	12,000	2,000	14,000	195,000	181,000	14,000	195,000	-	195,000	-	-	-
Operation and Maintenance, Air Force	-	-	-	4,377,000	-	-	-	-	262,000	262,000	4,639,000	4,377,000	262,000	4,639,000	-	4,639,000	-	-	-
Operation and Maintenance, Army National Guard	-	-	-	171,300	-	-	-	-	60	60	171,360	171,300	60	171,360	-	171,360	-	-	-
Operation and Maintenance, Air National Guard	-	-	-	193,400	-	-	-	-	1,000	1,000	194,400	193,400	1,000	194,400	-	194,400	-	-	-
Promotion of Rifle Practice, Army	-	-	-	500	-	-	-	-	-	-	500	500	-	500	-	500	-	-	-
Operation and Maintenance, Alaska Communication System, Army	-	-	-	6,300	-	-	-	-	-	-	6,300	6,300	-	6,300	-	6,300	-	-	-
Salaries and Expenses, Secretary of Defense	-	-	-	21,000	-	-	-	-	-	-	21,000	21,000	-	21,000	-	21,000	-	-	-
Contingencies, Department of Defense	-	-	-	30,000	-	-	-	-	-	-	30,000	30,000	-	30,000	-	30,000	-	-	-
Claims, Department of Defense	-	-	-	19,000	-	-	-	-	-	-	19,000	19,000	-	19,000	-	19,000	-	-	-
Salaries and Expenses, Ct. of Military Appeals, DOD	-	-	-	445	-	-	-	-	-	-	445	445	-	445	-	445	-	-	-
TOTAL - OPERATION AND MAINTENANCE	69,443	-	69,443	11,039,945	-	-	-	92,000	764,660	856,660	11,966,048	11,039,945	893,060	11,933,005	-	11,933,005		33,043	33,043
PROCUREMENT																			
Procurement of Equipment and Missiles, Army	242,896	45,000	287,896	1,912,000	-	-	-	-	266,000	266,000	2,465,896	1,947,000	307,000	2,254,000	211,896	2,465,896	211,896	-	211,896
Procurement of Aircraft and Missiles, Navy	524,815	30,000	554,815	2,192,000	-	-	-	-	31,000	31,000	2,777,815	2,087,100	34,000	2,121,100	656,715	2,777,815	656,715	-	656,715
Shipbuilding and Conversion, Navy	591,222	-	591,222	2,915,000	-	-	-	-	4,000	4,000	3,510,222	2,550,600	24,000	2,574,600	302,000	2,876,600	302,000	633,622	935,622
Other Procurement, Navy	36,199	-	36,199	704,000	-	-	-	-	23,400	23,400	763,599	698,000	37,000	735,000	16,684	751,684	16,684	11,915	28,599
Procurement, Marine Corps	60,239	-	60,239	165,000	-	-	-	-	-	-	225,239	172,900	-	172,900	52,339	225,239	52,339	-	52,339
Aircraft Procurement, Air Force	987,663	133,200	1,120,863	2,989,000	-	-	-	-	90,000	90,000	4,199,863	3,352,300	90,000	3,442,300	457,500	3,899,800	457,500	300,063	757,563
Airlift Modernization, Air Force	46,300	36,688	82,988	298,000	-	-	-	-	-	-	380,988	326,800	-	326,800	31,400	358,200	31,400	22,788	54,188
Missile Procurement, Air Force	636,039	-	636,039	2,792,000	-	-	-	-	-	-	3,428,039	2,801,000	21,400	2,822,400	585,622	3,408,022	585,622	20,017	605,639
Other Procurement, Air Force	316,864	10,000	326,864	1,002,000	-	-	-	-	20,000	20,000	1,348,864	1,046,000	20,000	1,066,000	232,864	1,298,864	232,864	50,000	282,864
Aircraft and Related Procurement, Navy	376,667	-	376,667	-	-	-	-	-	-	-	376,667	250,000	-	250,000	126,667	376,667	126,667	-	126,667
Procurement of Ordnance and Ammunition, Navy	28,312	-	28,312	-	-	-	-	-	-	-	28,312	-	28,312	28,312	-	28,312	-	-	-
Aircraft, Missiles & Related Procurement, Air Force	25,874	-	25,874	-	-	-	-	-	-	-	25,874	25,874	-	25,874	-	25,874	-	-	-
Procurement other than Aircraft & Missiles, Air Force	28,631	-	28,631	-	-	-	-	-	-	-	28,631	28,631	-	28,631	-	28,631	-	-	-
TOTAL - PROCUREMENT	3,901,721	254,888	4,156,609	14,969,000	-	-	-	-	434,400	434,400	19,560,009	15,286,205	561,712	15,847,917	2,673,687	18,521,604	2,673,687	1,038,405	3,712,092

OASD Comptroller
FAD-394
28 March 1961
~~Replaces FAD-394~~
dated 16 Jan. 1961

66841 O - 61 (Face p. 654) No. 3

Department of Defense

FINANCIAL PLAN FOR FY 1962

Obligation Plan for General Fund Appropriations

FY 1962

OBLIGATIONS

Thousands of Dollars

Appropriation title	Status of unobligated balance brought forward		Resources available for obligation in FY 1962				Anticipated reimbursements based on orders to be received in FY 1962					Planned apportionment program					Unobligated balance available in FY 1963		
	Available for completion of prior year programs	Available to finance FY 1962 programs	Unobligated balance brought forward	FY 1962 appropriations	Proposed supplemental	Transfers	From FY 1962 MAP .002 orders a/	From orders subject to automatic apportionment	From all other sources	Total anticipated reimbursements	Total obligational availability (cols 4+5+6+7+11)	Planned obligations: For service account obligations (direct)	Planned obligations: Obligations for customer orders	Planned obligations: Total (Cols 13+14)	Planned for commitment in FY 1962 (to be unobligated on 30 Jun '62)	Total planned apportionment program (cols 15+16)	Planned for commitment (to be unobligated on 30 Jun '62)	Reserved for completion of FY 1962 and prior year programs	Total available for completion of FY 1962 and prior year programs
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
RESEARCH, DEVELOPMENT, TEST, AND EVALUATION																			
Research, Development, Test, and Evaluation, Army	37,736	-	37,736	1,205,400	-	-	-	-	12,000	12,000	1,255,136	1,205,400	12,000	1,217,400	37,736	1,255,136	37,736	-	37,736
Research, Development, Test, and Evaluation, Navy	22,178	10,000	32,178	1,306,000	-	-	-	37,000	1,000	38,000	1,376,178	1,297,900	38,000	1,335,900	40,278	1,376,178	40,278	-	40,278
Research, Development, Test, and Evaluation, Air Force	125,564	84,500	210,064	1,878,000	-	-	-	-	150,000	150,000	2,238,064	1,908,000	150,000	2,058,000	180,064	2,238,064	180,064	-	180,064
Salaries & Expenses, Advanced Research Projects Agency, DOD	38,741	-	38,741	186,000	-	-	-	-	-	-	224,741	186,000	-	186,000	38,741	224,741	38,741	-	38,741
Emergency Fund, Department of Defense	-	-	-	150,000	-	-	-	-	-	-	150,000	150,000	-	150,000	-	150,000	-	-	-
TOTAL - RESEARCH, DEVELOPMENT, TEST, AND EVALUATION	224,219	94,500	318,719	4,725,400	-	-	-	37,000	163,000	200,000	5,244,119	4,747,300	200,000	4,947,300	296,819	5,244,119	296,819	-	296,819
MILITARY CONSTRUCTION																			
Military Construction, Army	91,852	-	91,852	210,000	-	-	-	-	6,000	6,000	307,852	211,000	6,000	217,000	90,852	307,852	90,852	-	90,852
Military Construction, Navy	70,985	-	70,985	206,000	-	-	-	-	15,000	15,000	291,985	202,000	15,000	217,000	74,985	291,985	74,985	-	74,985
Military Construction, Air Force	367,415	-	367,415	550 ~~500~~,000	-	-	-	-	5,000	5,000	922,415	697,800	5,000	702,800	219,615	922,415	219,615	-	219,615
Military Construction, Army Reserve	6,221	-	6,221	13,000	-	-	-	-	-	-	19,221	16,000	-	16,000	3,221	19,221	3,221	-	3,221
Military Construction, Naval Reserve	3,489	-	3,489	7,000	-	-	-	-	-	-	10,489	9,000	-	9,000	1,489	10,489	1,489	-	1,489
Military Construction, Air Force Reserve	363	-	363	4,000	-	-	-	-	-	-	4,363	4,000	-	4,000	363	4,363	363	-	363
Military Construction, Army National Guard	4,091	-	4,091	12,000	-	-	-	-	-	-	16,091	14,000	-	14,000	2,091	16,091	2,091	-	2,091
Military Construction, Air National Guard	2,530	350	2,880	14,000	-	-	-	-	-	-	16,880	15,000	-	15,000	1,880	16,880	1,880	-	1,880
Loran Stations, Department of Defense	-	-	-	10,000	-	-	-	-	-	-	10,000	10,000	-	10,000	-	10,000	-	-	-
Construction, Alaska Communication System, Army	-	437	437	-	-	-	-	-	-	-	437	-	-	-	-	-	-	437	437
Military Construction, Advanced Research Projects Ag., DOD		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL - MILITARY CONSTRUCTION	546,946	787	547,733	1,026 ~~976~~,000	-	-	-	-	26,000	26,000	1,599,733	1,178,800	26,000	1,204,800	394,496	1,599,296	394,496	437	394,933
DEPARTMENT OF DEFENSE																			
Department of the Army	452,239	45,437	497,676	10,455,500	-	340,000	-	-	891,460	891,460	12,184,636	10,836,500	968,860	11,805,360	345,796	12,151,156	345,796	33,480	379,276
Department of the Navy	1,714,105	40,000	1,754,105	13,722,000	-	66,000	-	129,000	171,090	300,090	15,842,196	13,560,500	365,002	13,925,502	1,271,157	15,196,659	1,271,157	645,537	1,916,694
Department of the Air Force	2,537,243	264,738	2,801,981	18,229,400	-	64,000	-	-	556,149	556,149	21,651,530	18,971,805	577,549	19,549,354	1,709,308	21,258,662	1,709,308	392,868	2,102,176
Office of the Secretary of Defense	38,741	-	38,741	1,336,445	31,000	-	-	-	-	-	1,406,186	1,367,445	-	1,367,445	38,741	1,406,186	38,741	-	38,741
TOTAL - DEPARTMENT OF DEFENSE	4,742,328	350,175	5,092,503	43,743,345	31,000	b 470,000	-	129,000	1,618,699	1,747,699	c 51,084,548	44,736,250	1,911,411	46,647,661	3,365,001	50,012,662	3,365,001	1,071,885	4,436,886

a/ Does not include any FY 1962 MAP Common Item Orders since value and distribution of such orders are not determinable at this time.
b/ Excludes proposed $30 million reappropriation transfer of unexpended balances from expired accounts to the revolving fund account "Acquisition, Rehabilitation and Renatal of Wherry Act Housing."
c/ The total obligational availability is the sum of the amounts available to each individual appropriation account. Consequently, the totals of the appropriation groupings as well as the departmental and DOD totals are overstated by the "duplicate count" of reimbursements arising from intra-service and inter-service reimbursement transactions which in grand total, amount to approximately $1.0 billion.

Approved: [signature]
Assistant Secretary of Defense
(Comptroller)

OASD Comptroller
FAD-394
28 March 1961
Replaces FAD-394
dated 16 Jan. 1961

66841 O - 61 (Face p. 654) No. 4

Department of Defense

FINANCIAL PLAN FOR FY 1961 - 1962

Expenditures and Gross Unpaid Obligations

Thousands of Dollars

	Balances, 1 Jul 1960		FY 1961 transactions								Balances, 1 Jul 1961		FY 1962 transactions								Balances, 1 Jul 1962	
				Expenditures			Obligations							Expenditures			Obligations					
	Gross unpaid obligations	Treasury unexpended cash balance	New expenditure availability	Gross payments	Reimbursement collections	Net expenditures (Col 5-6)	Obligations incurred	Obligation transfers and adjustments	Restorations (+) and write-offs (-)	Gross unpaid obligations (Col 2-5 +8±9)	Treasury unexpended cash balance (Col 3+4 -7±10)	New expenditure availability	Gross payments	Reimbursement collections	Net expenditures (Col 14-15)	Obligations incurred	Obligation transfers and adjustments	Restorations (+) and write-offs (-)	Gross unpaid obligations (Col 11-14 +17±18)	Treasury unexpended cash balance (Col 12+13 -16±19)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
MILITARY PERSONNEL																				
Military Personnel, Army	300,280	a 287,287	3,514,548	3,771,500	173,000	3,598,500	3,687,548	-	-	216,328	203,335	3,542,000	3,714,000	168,000	3,546,000	3,707,000	-	-	209,328	199,335
Military Personnel, Navy	87,182	87,182	2,598,244	2,612,896	26,896	2,586,000	2,631,000	-	-	105,285	99,426	2,655,000	2,677,823	32,823	2,645,000	2,685,000	-	-	112,462	109,426
Military Personnel, Marine Corps	23,481	a 21,778	607,246	610,263	7,263	603,000	613,000	-	-746	26,218	25,278	628,000	629,553	5,553	624,000	633,500	-	-	30,165	29,278
Military Personnel, Air Force	218,516	a 213,118	4,049,676	4,051,600	31,000	4,020,600	4,079,784	-	-892	246,700	241,302	4,097,000	4,106,000	28,000	4,078,000	4,125,000	-	-	265,700	260,302
Reserve Personnel, Army	35,971	35,971	233,998	224,000	1,000	223,000	220,598	-	-14,400	32,569	32,569	199,000	203,800	800	203,000	199,800	-	-	28,569	28,569
Reserve Personnel, Navy	17,370	17,370	87,584	85,000	-	85,000	85,584	-	-2,000	17,954	17,954	84,600	82,000	-	82,000	84,600	-	-	20,554	20,554
Reserve Personnel, Marine Corps	3,333	3,314	24,831	24,791	291	24,500	25,111	-	-	3,653	3,645	26,400	25,198	198	25,000	26,590	-	-	5,045	5,045
Reserve Personnel, Air Force	5,980	5,973	54,000	52,025	25	52,000	53,237	-	-788	7,192	7,185	52,000	50,020	20	50,000	52,020	-	-	9,192	9,185
National Guard Personnel, Army	36,726	36,726	230,277	230,000	1,000	229,000	231,377	-	-	38,103	38,003	202,000	209,000	1,000	208,000	203,000	-	-	32,103	32,003
National Guard Personnel, Air Force	8,011	7,808	46,000	46,300	300	46,000	46,128	-	-	7,839	7,808	47,000	46,129	129	46,000	47,129	-	-	8,839	8,808
Retired Pay, Department of Defense b/	9,289	9,289	790,000	785,000	-	785,000	790,000	-	-	14,289	14,289	951,000	948,555	-	948,555	951,000	-	-	16,734	16,734
TOTAL - MILITARY PERSONNEL	746,138	725,815	12,236,404	12,493,375	240,775	12,252,600	12,463,367	-	-18,826	716,130	690,794	12,484,000	12,692,078	236,523	12,455,555	12,714,639	-	-	738,691	719,239
OPERATION AND MAINTENANCE																				
Operation and Maintenance, Army	778,242	a 631,686	3,204,572	3,602,000	450,000	3,152,000	3,696,572	-	-	872,814	684,258	3,322,000	3,779,000	517,000	3,262,000	3,799,000	-	-	892,814	744,258
Operation and Maintenance, Navy	629,322	a 571,067	2,598,732	2,749,899	149,706	2,600,193	2,756,626	2,106	-	638,155	569,605	2,718,000	2,815,900	150,000	2,665,900	2,857,000	-	-	679,255	621,705
Operation and Maintenance, Marine Corps	39,164	30,581	176,725	193,429	21,429	172,000	192,725	-	-	38,460	35,306	181,000	193,451	14,851	178,600	195,000	-	-	40,009	37,706
Operation and Maintenance, Air Force	908,314	864,858	4,314,587	4,555,000	287,000	4,268,000	4,597,587	-	-	950,901	911,445	4,377,000	4,578,300	277,000	4,301,300	4,639,000	-	-	1,011,601	987,145
Operation and Maintenance, Army National Guard	20,568	20,568	166,316	160,060	60	160,000	166,376	-	-	26,884	26,884	171,300	170,060	60	170,000	171,360	-	-	28,184	28,184
Operation and Maintenance, Air National Guard	18,583	18,450	189,481	182,900	900	182,000	190,430	-	-	26,113	25,931	193,400	192,000	1,000	191,000	194,400	-	-	28,513	28,331
Promotion of Rifle Practice, Army	69	69	501	500	-	500	501	-	-	70	70	500	500	-	500	500	-	-	70	70
Operation & Maintenance, Alaska Comm. System, Army	1,677	1,677	7,230	7,000	-	7,000	7,230	-	-	1,907	1,907	6,300	7,000	-	7,000	6,300	-	-	1,207	1,207
Salaries and Expenses, Secretary of Defense	4,084	4,084	19,850	20,000	-	20,000	19,850	-	-	3,934	3,934	21,000	21,000	-	21,000	21,000	-	-	3,934	3,934
Contingencies, Department of Defense	1,870	1,870	15,000	9,250	-	9,250	15,000	-	-	7,620	7,620	30,000	30,000	-	30,000	30,000	-	-	7,620	7,620
Claims, Department of Defense	1,183	1,183	22,575	19,000	-	19,000	22,575	-	-	4,758	4,758	19,000	19,750	-	19,750	19,000	-3,000	-3,000	1,008	1,008
Salaries & Expenses, Court of Military Appeals, DOD	46	46	425	425	-	425	425	-	-	46	46	445	445	-	445	445	-	-	46	46
Operation & Maintenance, Olympic Winter Games, DOD	295	295	-	295	-	295	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Miscellaneous Expired Accounts, Army	412	412	-	-	-	-	-	-	-	412	412	-	-	-	-	-	-	-	412	412
Miscellaneous Expired Accounts, Navy	2,753	2,753	-2,106	647	-	647	-	-2,106	-	-	-	-	-	-	-	-	-	-	-	-
Miscellaneous Expired Accounts, Air Force	492	492	-	50	-	50	-	-	-	442	442	-	50	-	50	-	-	-	392	392
Miscellaneous Expired Accounts, OSD	946	946	-	946	-	946	-	-	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL - OPERATION AND MAINTENANCE	2,408,020	2,151,034	10,713,888	11,501,401	909,095	10,592,306	11,665,897	-	-	2,572,516	2,272,617	11,039,945	11,807,456	959,911	10,847,545	11,933,005	-3,000	-3,000	2,695,065	2,462,017
PROCUREMENT																				
Procurement of Equipment and Missiles, Army	2,322,823	1,968,175	1,491,452	1,914,400	431,000	1,483,400	2,334,785	-	-	2,743,208	1,976,227	1,912,000	2,291,000	545,000	1,746,000	2,254,000	-	-	2,706,208	2,142,227
Procurement of Aircraft and Missiles, Navy	-	-	2,326,115	263,800	9,700	254,100	1,824,300	-	-	1,560,500	2,072,015	2,192,000	1,119,400	34,000	1,085,400	2,121,100	-	-	2,562,200	3,178,615
Shipbuilding and Conversion, Navy b/	2,947,504	3,660,939	2,293,590	1,881,523	58,323	1,823,200	2,553,100	-	-	3,619,081	4,131,329	2,915,000	2,034,800	34,000	2,000,800	2,574,600	-	-	4,158,881	5,045,529
Other Procurement, Navy	-	-	502,480	99,155	25,855	73,300	589,600	-	-	490,445	429,180	704,000	448,945	50,045	398,900	735,000	-	-	776,500	734,280
Procurement, Marine Corps	323,060	430,176	91,180	157,000	2,000	155,000	144,470	-	-	310,530	366,356	165,000	165,500	2,000	163,500	172,900	-	-	317,930	367,856
Aircraft Procurement, Air Force	2,394,404	3,724,317	3,735,649	3,092,800	186,100	2,906,700	4,355,200	-	-	3,656,804	4,553,266	2,989,000	4,010,120	228,000	3,782,120	3,442,300	-	-	3,088,984	3,760,146
Airlift Modernization, Air Force	-	-	310,788	30,000	-	30,000	232,000	-	-	202,000	280,788	298,000	179,600	4,000	175,600	326,800	-	-	349,200	403,188
Missile Procurement, Air Force	1,251,802	1,443,255	3,313,820	2,635,200	61,000	2,574,200	3,171,100	-	-	1,787,702	2,182,875	2,792,000	3,039,000	60,000	2,979,000	2,822,400	-	-	1,571,102	1,995,875
Other Procurement, Air Force	626,252	940,407	939,926	675,000	40,000	635,000	1,101,000	-	-	1,052,252	1,245,333	1,002,000	956,000	75,000	881,000	1,066,000	-	-	1,162,252	1,366,333
Aircraft and Related Procurement, Navy	2,515,405	3,831,847	-274,115	1,805,000	46,000	1,759,000	776,500	-	-	1,486,905	1,798,732	-	1,090,637	20,637	1,070,000	250,000	-	-	646,268	728,732
Procurement of Ordnance & Ammunition, Navy	708,374	681,319	-2,400	465,000	35,000	430,000	79,000	-	-	322,374	248,919	-	183,000	33,000	150,000	28,312	-	-	167,686	98,919
Aircraft, Missiles & Related Procurement, Air Force	2,234,374	3,500,679	-1,354,200	1,841,150	140,150	1,701,000	215,000	-150,000	-	458,224	445,479	-	350,000	39,000	311,000	25,874	-	-	134,098	134,479
Procurement other than Aircraft & Missiles, A. F.	1,082,276	1,129,585	-76,055	810,000	110,000	700,000	97,000	-	-	369,276	353,530	-	215,000	45,000	170,000	28,631	-	-	182,907	183,530
TOTAL - PROCUREMENT	16,406,274	21,310,699	13,298,230	15,670,028	1,145,128	14,524,900	17,473,055	-150,000	-	18,059,301	20,084,029	14,969,000	16,083,002	1,169,682	14,913,320	15,847,917	-	-	17,824,216	20,139,709
RESEARCH, DEVELOPMENT, TEST, AND EVALUATION																				
Research, Development, Test, and Evaluation, Army	650,798	739,442	1,102,478	1,026,000	15,000	1,011,000	1,180,192	-	-	804,990	830,920	1,205,400	1,148,000	13,000	1,135,000	1,217,400	-	-	874,390	901,320
Research, Development, Test, and Evaluation, Navy	626,625	683,416	1,318,979	1,157,100	33,000	1,124,100	1,410,160	-	-	879,685	878,295	1,306,000	1,313,000	37,000	1,276,000	1,335,900	-	-	902,585	908,295
Research, Development, Test, and Evaluation, A. F.	745,450	866,062	1,737,413	1,665,000	165,000	1,500,000	1,926,600	-	-	1,007,050	1,103,475	1,878,000	1,926,000	160,000	1,766,000	2,058,000	-	-	1,139,050	1,215,475
Salaries & Expenses, Advanced Research Proj. Ag., DOD	188,435	311,176	160,459	235,500	500	235,000	244,959	-	-	197,894	236,635	186,000	256,000	-	256,000	186,000	-	-	127,894	166,635
Emergency Fund, DOD	-	-	132,033	38,035	-	38,035	132,033	-	-	93,998	93,998	150,000	143,100	-	143,100	150,000	-	-	100,898	100,898
TOTAL - RESEARCH, DEVELOPMENT, TEST AND EVAL.	2,211,308	2,600,096	4,451,362	4,121,635	213,500	3,908,135	4,893,944	-	-	2,983,617	3,143,323	4,725,400	4,786,100	210,000	4,576,100	4,947,300	-	-	3,144,817	3,292,623

See footnotes on page 2.

OASD Comptroller
FAD-399
28 March 1961
Replaces FAD-399
dated 16 Jan. 1961

66841 O - 61 (Face p. 654) No. 5

Department of Defense

FINANCIAL PLAN FOR FY 1961 - 1962

FY 1961 - 1962
EXPENDITURES

Expenditures and Gross Unpaid Obligations

Thousands of Dollars

Appropriation title	Balances, 1 Jul 1960: Gross unpaid obligations	Balances, 1 Jul 1960: Treasury unexpended cash balance	FY 1961 transactions: New expenditure availability	FY 1961 Expenditures: Gross payments	FY 1961 Expenditures: Reimbursement collections	FY 1961 Expenditures: Net expenditures (Col 5-6)	FY 1961 Obligations: Obligations incurred	FY 1961 Obligations: Obligation transfers and adjustments	FY 1961: Restorations (+) and write-offs (-)	Balances, 1 Jul 1961: Gross unpaid obligations (Col 2-5 +8±9)	Balances, 1 Jul 1961: Treasury unexpended cash balance (Col 3+4 -7±10)	FY 1962 transactions: New expenditure availability	FY 1962 Expenditures: Gross payments	FY 1962 Expenditures: Reimbursement collections	FY 1962 Expenditures: Net expenditures (Col 14-15)	FY 1962 Obligations: Obligations incurred	FY 1962 Obligations: Obligation transfers and adjustments	FY 1962: Restorations (+) and write-offs (-)	Balances, 1 Jul 1962: Gross unpaid obligations (Col 11-14 +17±18)	Balances, 1 Jul 1962: Treasury unexpended cash balance (Col 12+13 -16±19)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
MILITARY CONSTRUCTION																				
Military Construction, Army	202,308	340,753	148,407	237,000	9,000	228,000	252,613	-	-	217,921	261,160	210,000	239,280	42,000	197,280	217,000	-	-	195,641	273,880
Military Construction, Navy	294,223	378,869	162,519	252,000	8,000	244,000	195,000	-	-	237,223	297,388	206,000	202,000	15,000	187,000	217,000	-	-	252,223	316,388
Military Construction, Air Force	751,339	1,369,966	609,501	964,154	5,500	958,654	866,700	-	-	653,885	1,020,813	550,000	766,200	5,000	761,200	702,800	-	-	590,485	809,613
Military Construction, Army Reserve	14,050	23,233	16,038	17,000	-	17,000	19,000	-	-	16,050	22,271	13,000	17,800	-	17,800	16,000	-	-	14,250	17,471
Military Construction, Naval Reserve	6,397	15,885	4,000	8,000	-	8,000	10,000	-	-	8,397	11,885	7,000	8,500	-	8,500	9,000	-	-	8,897	10,385
Military Construction, Air Force Reserve	2,407	3,770	4,000	4,000	-	4,000	5,000	-	-	3,407	3,770	4,000	4,000	-	4,000	4,000	-	-	3,407	3,770
Military Construction, Army National Guard	18,879	32,430	17,540	18,000	-	18,000	27,000	-	-	27,879	31,970	12,000	22,900	-	22,900	14,000	-	-	18,979	21,070
Military Construction, Air National Guard	11,395	16,425	13,850	15,000	-	15,000	16,000	-	-	12,395	15,275	14,000	16,000	-	16,000	15,000	-	-	11,395	13,275
Loran Stations, Department of Defense	-	-	19,000	19,000	-	19,000	19,000	-	-	-	-	10,000	10,000	-	10,000	10,000	-	-	-	-
Construction, Alaska Communication System, Army	150	608	-	150	-	150	21	-	-	21	458	-	20	-	20	-	-	-	1	438
Military Construction, Advanced Res. Proj. Ag., DOD	7,720	27,083	5,541	15,000	-	15,000	24,904	-	-	17,624	17,624	-	14,000	-	14,000	-	-	-	3,624	3,624
Military Construction, Foreign Countries, DOD	35,150	35,150	-	8,000	-	8,000	-	-	-	27,150	27,150	-	8,000	-	8,000	-	-	-	19,150	19,150
TOTAL - MILITARY CONSTRUCTION	1,344,018	2,244,170	1,000,396	1,557,304	22,500	1,534,804	1,435,238	-	-	1,221,952	1,709,762	1,026,000	1,308,700	62,000	1,246,700	1,204,800	-	-	1,118,052	1,489,062
SUB-TOTAL - General and Special Accounts																				
Department of the Army	4,382,953	4,119,037	10,133,357	11,207,610	1,080,060	10,127,550	11,823,813	-	-14,400	4,999,156	4,110,444	10,795,500	11,802,360	1,286,860	10,515,500	11,805,360	-	-	5,002,156	4,390,444
Department of the Navy	8,224,193	10,416,496	12,513,604	12,365,503	423,463	11,942,040	13,886,176	-	-2,746	9,744,865	10,985,313	13,788,000	12,989,707	429,107	12,560,600	13,925,502	-	-	10,680,660	12,212,713
Department of the Air Force	10,259,595	14,105,163	17,888,436	20,620,179	1,026,975	19,593,204	20,952,766	-150,000	-1,680	10,442,182	12,398,717	18,293,400	20,434,419	922,149	19,512,270	19,549,354	-	-	9,557,117	11,179,847
Office of the Secretary of Defense	249,018	391,120	1,164,883	1,150,450	500	1,149,950	1,268,746	-	-	367,313	406,054	1,367,445	1,450,850	-	1,450,850	1,367,445	-3,000	-3,000	280,908	319,649
SUB-TOTAL - GENERAL & SPECIAL ACCOUNTS	23,115,758	29,031,814	41,700,280	45,343,742	2,530,998	42,812,744	47,931,501	-150,000	-18,826	25,553,516	27,900,526	44,244,345	46,677,335	2,638,115	44,039,220	46,647,661	-3,000	-3,000	25,520,842	28,102,651
REVOLVING AND MANAGEMENT FUNDS																				
Acquisition, Rehabilitation and Rental of Wherry Act Housing, Department of Defense	-	139,103	30,000	90,000	60,000	30,000	-	-	-	-	139,103	20,000	100,000	65,000	35,000	-	-	-	-	124,103
Defense Housing, Army	-	117	-	460	630	-170	-	-	-200	-	87	-	427	597	-170	-	-	-150	-	107
Defense Housing, Navy	-	524	-	1,131	1,300	-169	-	-	-300	-	393	-	1,100	1,285	-185	-	-	-200	-	378
Laundry Service, Naval Academy	-	103	-	612	590	22	-	-	-	-	81	-	606	600	6	-	-	-	-	75
Army Stock Fund	-	560,074	-260,000	2,144,107	2,394,107	-250,000	-	-	-	-	550,074	-240,000	2,312,094	2,522,094	-210,000	-	-	-	-	520,074
Navy Stock Fund	-	214,631	-75,000	1,140,200	1,213,600	-73,400	-	-	-	-	213,031	-35,000	1,178,600	1,215,200	-36,600	-	-	-	-	214,631
Marine Corps Stock Fund	-	23,147	-500	108,700	113,700	-5,000	-	-	-	-	27,647	-11,000	111,000	116,000	-5,000	-	-	-	-	21,647
Air Force Stock Fund	-	261,431	-30,000	1,280,000	1,301,000	-21,000	-	-	-	-	252,431	-44,000	1,248,000	1,248,000	-	-	-	-	-	208,431
Army Industrial Fund	-	179,490	-	706,010	706,010	-	-	-	-	-	179,490	-100,000	720,442	720,442	-	-	-	-	-	79,490
Navy Industrial Fund	-	147,976	-	1,584,400	1,574,400	10,000	-	-	-	-	137,976	-20,000	1,547,000	1,562,000	-15,000	-	-	-	-	132,976
Air Force Industrial Fund	-	41,557	-	322,500	339,500	-17,000	-	-	-1,817	-	56,740	-20,000	342,688	342,688	-	-	-	-	-	36,740
Army Management Fund	-	6,931	-	256,808	256,808	-	-	-	-	-	6,931	-	257,611	257,611	-	-	-	-	-	6,931
Navy Management Fund	-	105,460	-	1,230,604	1,219,797	10,807	-	-	-	-	96,653	-	1,506,868	1,516,189	-9,321	-	-	-	-	103,974
Air Force Management Fund	-	5,207	-	6,818	5,702	1,116	-	-	-62	-	4,029	-	5,700	5,700	-	-	-	-	-	4,029
Naval Working Fund	-	12,913	-	25,000	23,000	2,000	-	-	-	-	10,913	-	23,000	21,000	2,000	-	-	-	-	8,913
Consolidated Working Funds, Army	-	3,362	-	3,500	3,500	-	-	-	-4	-	3,358	-	2,988	2,988	-	-	-	-	-	3,358
Consolidated Working Funds, Air Force	-	146	-	50	-	50	-	-	-	-	96	-	50	-	50	-	-	-	-	46
TOTAL - REVOLVING AND MANAGEMENT FUNDS	-	1,702,173	-335,500	8,900,900	9,213,644	-312,744	-	-	-2,382	-	1,677,035	-450,000	9,358,174	9,597,394	-239,220	-	-	-350	-	1,465,905
DEPARTMENT OF DEFENSE - TOTALS																				
Department of the Army	-	4,869,011	9,873,357	14,318,495	4,441,115	9,877,380	-	-	-14,604	-	4,850,384	10,455,500	15,095,922	4,790,592	10,305,330	-	-	-150	-	5,000,404
Department of the Navy	-	10,921,250	12,438,104	16,456,150	4,569,850	11,886,300	-	-	-3,046	-	11,470,007	13,722,000	17,357,881	4,861,381	12,496,500	-	-	-200	-	12,695,307
Department of the Air Force	-	14,413,504	17,858,436	22,229,547	2,673,177	19,556,370	-	-	-3,559	-	12,712,013	18,229,400	22,030,857	2,518,537	19,512,320	-	-	-	-	11,429,093
Office of the Secretary of Defense	-	530,223	1,194,883	1,240,450	60,500	1,179,950	-	-	-	-	545,157	1,387,445	1,550,850	65,000	1,485,850	-	-	-3,000	-	443,752
TOTAL - DEPARTMENT OF DEFENSE (MILITARY FUNCTIONS)	-	30,733,988	41,364,780	54,244,642	11,744,642	42,500,000	-	-	-21,208	-	29,577,559	43,794,345	56,035,509	12,235,509	43,800,000	-	-	-3,350	-	29,568,554

a/ These balances have not been reduced by the over-expenditures in 1959 and prior year accounts for which deficiency appropriations totaling $74,410 thousand will be required.
b/ Entries include effects of anticipated FY 1961 supplemental appropriations proposed for later transmission: Retired Pay, DOD, $15 million; Shipbuilding and Conversion, Navy, $48 million.

OASD Comptroller
FAD-399
28 March 1961
Replaces FAD-399
dated 16 Jan. 1961

Approved: C J Hitch
Charles J. Hitch
Assistant Secretary of Defense
(Comptroller)

Department of Defense

NEW OBLIGATIONAL AUTHORITY, DIRECT OBLIGATIONS AND EXPENDITURES
Changes from FY 1962 Budget Document

Fiscal Years 1960 - 1962

(Millions of Dollars)

	New Obligational Authority		Direct Obligations		Expenditures	
	FY 1961	FY 1962	FY 1961	FY 1962	FY 1961	FY 1962
By Functional Title						
MILITARY PERSONNEL	+15	+68	+22	+68	+110	+66
Active Forces	-	+43	+ 7	+43	+100	+43
Reserve Forces	-	-	-	-	-	-
Retired Pay	+15	+25	+15	+25	+10	+23
OPERATION AND MAINTENANCE	-	+198	-	+198	+38	+131
PROCUREMENT	+48	+1,591	+1,001	+645	+558	+490
Aircraft	-	+166	+131	-40	+123	+ 9
Missiles	-	+146	+209	+43	+259	+170
Ships	+48	+1,090	+595	+477	+53	+226
Other	-	+188	+66	+166	+123	+86
RESEARCH, DEVELOPMENT, TEST, AND EVALUATION	-5	+376	+6	+382	+129	+284
MILITARY CONSTRUCTION	+5	+41	+32	+20	+167	-80
Active Forces	+5	+41	+22	+26	+165	-85
Reserve Forces	-	-	+10	-6	+2	+5
REVOLVING AND MANAGEMENT FUNDS	-	-	xxx	xxx	-1	-2
Sub-total	-63	+2,274	+1,061	+1,313	+1,000	+890
Available by transfer of prior year balances	-	-320				
TOTAL, MILITARY FUNCTIONS	+63	+1,954	+1,061	+1,313	+1,000	+890
By Service						
Department of the Army	+3	+266	+19	+242	+262	+232
Department of the Navy	+54	+1,551	+762	+758	+121	+418
Department of the Air Force	-	+412	+274	+266	+666	+168
Office of the Secretary of Defense	+6	+46	+6	+46	-50	+71
Sub-total	+63	+2,274	+1,061	+1,313	+1,000	+890
Available by transfer of prior Year balances	-	-320				
Army	-	-215				
Navy	-	-66				
Air Force	-	-39				
TOTAL, MILITARY FUNCTIONS	+63	+1,954	+1,061	+1,313	+1,000	+890

NOTE: Includes effect of anticipated FY 1961 supplemental appropriations proposed for later transmission: Retired Pay, DOD, $15 million; and Shipbuilding and Conversion, Navy, $48 million.

SUMMARY BY PROGRAM OF PROPOSED ADJUSTMENTS
IN NEW OBLIGATIONAL AUTHORITY IN FY 1962 BUDGET

(Millions of Dollars)

Program	Proposed adjust-ments
I. Strengthening and Protecting our Strategic Deterrent and Defenses	
A. Improving our missile deterrent	
1. POLARIS Accelerate production schedule Accelerate A-3 development Increase Personnel	+1,340.8
2. MINUTEMAN Substitute three fixed for three mobile squadrons Expand production capacity Improve Missile	+96.0
3. SKYBOLT	+50.0
B. Protecting our bomber deterrent	
1. Increased ground alert force and bomb alarms	+44.6
C. Improving our Continental defense and warning systems	
1. MIDAS	+60.0
2. Back-up control of Air Defense Interceptors	+23.0
D. Improving the Command and Control of our Strategic deterrent	+16.4
E. Other research programs related to strategic and continental air defense forces Penetration aids, DYNASOAR, ADVENT, DEFENDER, DISCOVERER, and others	+226.0
II. Strengthening our Ability to Deter or Confine Limited War	
A. Expanded research on non-nuclear weapons	+122.0
B. Increased flexibility of conventional forces	
1. Additional transport aircraft	+172.2
2. Additional amphibious transport, new type	+39.7
3. Navy ship rehabilitation and modernization program	+84.4
4. Procurement of new weapons, ammunition, etc.	+230.0
C. Increased non-nuclear capabilities of fighter aircraft	
1. Development of advanced tactical fighter	+45.0
2. Modification of F-105 tactical fighter	+24.6

SUMMARY BY PROGRAM OF PROPOSED ADJUSTMENTS
IN NEW OBLIGATIONAL AUTHORITY IN FY 1962 BUDGET (continued)

(Millions of Dollars)

Program	Proposed adjustments
II. Strengthening our Ability to Deter or Confine Limited War (continued)	
D. Increased personnel, training and readiness for conventional forces	
1. Increase in Army and Marine Corps personnel strengths	+39.0
2. Increase in retired pay	+25.0
3. Increased readiness training of Army and Air Force units	+65.3
III. Savings Made Possible by Progress	
A. TITAN II, Cancellation of two squadrons	-100.0
B. Phase-down of B-47 medium bomber wings	-34.7
C. Phase-out of SNARK	-6.9
D. B-70	-138.0
E. ANP	-35.0
F. EAGLE/MISSILEER	-57.7
G. Cancel installation of POLARIS on Cruiser Long Beach	-57.7
IV. Transfer from working capital funds	-320.0
NET TOTAL NOA REQUESTED	+1,954.0

SUMMARY OF DEFENSE DEPARTMENT BUDGET

(Millions of Dollars)

	New obligational authority			Net expenditures		
	FY 1960	FY 1961	FY 1962	FY 1960	FY 1961	FY 1962
1. Eisenhower Budget (FY 1962 Budget Document)	40,627.9	41,308.1	41,840.3	41,214.8	41,500.0	42,910.0
a. Effect of actions taken prior to 1/20/61 and underestimate	-	-	-	-	b 743.4	b 190.0
b. FY 1961 supplementals proposed for later transmission a/	-	63.0	-	-	18.0	45.0
2. Adjusted Budget 1/20/61	40,627.9	41,371.1	41,840.3	41,214.8	42,261.4	43,145.0
c. Effect of actions taken after 1/20/61 to accelerate FY 1961 c/	-	-	-	-	214.1	5.0
3. Adjusted Budget with accelerations	40,627.9	41,371.1	41,840.3	41,214.8	42,475.5	43,150.0
d. Effect of President Kennedy's Budget message	-	-	1,954.0	-	24.5	650.0
4. Budget proposed by President Kennedy	40,627.9	41,371.1	43,794.3	41,214.8	42,500.0	43,800.0

a/ Underestimate of Retired Pay ($15.0) and CONSTELLATION fire damage ($48.0).
b/ Underestimate of rate of expenditure of funds.
c/ Acceleration of approved procurement and construction actions in order to strengthen the military forces and stimulate the recovery.

Department of Defense Unpaid Obligations (outstanding orders) For Procurement and Research, Development, Test and Evaluation Compared With Unfilled Orders (Backlog) and Employment in the Durable Goods Industries

(Billions of Dollars, Thousands of Employees)
(End of Period)

Fiscal Year	DOD Unpaid Obligations for Proc. & RDT&E ($billions)	DURABLE GOODS INDUSTRIES Unfilled Orders ($billions)	Total Employees 1/ (000)
1954			
1st quarter	40.44	64.68	10,103
2d quarter	34.06	57.06	9,719
3d quarter	30.27	52.14	9,324
4th quarter	28.68	46.94	9,068
1955			
1st quarter	27.70	45.00	8,891
2d quarter	28.36	44.08	9,143
3d quarter	24.47	46.09	9,321
4th quarter	21.81	46.62	9,631
1956			
1st quarter	18.79	49.66	9,660
2d quarter	18.59	53.37	9,915
3d quarter	19.50	55.65	9,763
4th quarter	20.59	57.33	9,811
1957			
1st quarter	21.03	60.49	9,843
2d quarter	21.63	61.02	10,085
3d quarter	21.27	60.34	9,982
4th quarter	20.04	57.16	9,930
1958			
1st quarter	18.21	53.18	9,734
2d quarter	18.03	48.13	9,429
3d quarter	18.36	45.06	8,707
4th quarter	20.27	43.69	8,564
1959			
1st quarter	19.12	43.58	8,814
2d quarter	19.42	44.01	8,9[illegible]
3d quarter	19.39	47.24	9,218
4th quarter	20.37	46.98	9,581
1960			
1st quarter	18.90	47.85	9,225
2d quarter	18.09	48.13	9,577
3d quarter	17.60	46.28	9,330
4th quarter	19.41	44.50	9,504
1961			
1st quarter	19.22	44.68	9,403
2d quarter (prelim)	18.68	43.13	9,059
3d quarter	19.10 2/		
4th quarter	20.71 2/		
1962			
4th quarter	20.32 2/		

1/ Average employment for last month of quarter.

2/ Estimated from the fiscal year 1961 and 1962 Financial Plans associated with President Eisenhower's fiscal year 1962 budget submission.

NOTE: Department of Defense unpaid obligations for procurement, and research, development, test and evaluation include (1) the purchase of major items of equipment such as aircraft, missiles, ships, tanks, vehicles, ammunition, weapons, artillery, electronics, etc., and (2) the support of basic and applied research, general technical development, development of new weapons and equipment, fabrication and procurement of items under development for test and evaluation and the operation and maintenance of laboratories and test facilities. The data excludes unpaid obligations for soft goods such as subsistence, petroleum products and clothing and organizational equipment and supplies.

Source: Department of Defense fiscal data are from the Department of Defense: Monthly Status of Funds and the Department of Defense Financial Plans for fiscal years 1961 and 1962 dated 16 January 1961. Durable goods industries unfilled orders data are from the Department of Commerce: Survey of Current Business.

Durable goods industries employment data are from the Department of Labor: Monthly Labor Review.

Prepared by the Economic Advisor, OASD (Comptroller), January 23, 1961.

DEPARTMENT OF DEFENSE

Percentage Distribution of Expenditures for Procurement by Principal Subcategories
Fiscal Years 1953-1962
(Military Functions Only)

Procurement	Fiscal Year 1953	Fiscal Year 1954	Fiscal Year 1955	Fiscal Year 1956	Fiscal Year 1957	Fiscal Year 1958	Fiscal Year 1959	Fiscal Year 1960	Fiscal Year 1961 (Est)	Fiscal Year 1962 (Est)
Total Procurement	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Aircraft	47.3	56.9	68.6	64.1	64.1	62.4	53.6	45.3	42.1	41.1
Missiles	1.4	2.6	4.7	8.2	13.8	17.3	23.2	26.5	29.0	28.1
Ships	5.3	5.7	7.4	7.0	6.2	7.8	10.3	12.2	12.1	12.9
Ordnance, Vehicles and Related Equipment	27.1	20.9	9.3	10.3	5.0	2.6	2.8	3.1	4.4	6.6
Electronics & Communications	5.4	4.4	3.4	5.4	5.2	4.7	5.0	7.6	7.6	7.4
Other Equipment	13.4	9.5	6.7	5.0	5.7	5.1	5.1	5.3	4.9	3.9

Detail may not add to totals due to rounding.

NOTE: Data are based on order of magnitude estimates which assume that the Fiscal Year 1961 Budget structure had been adopted circa 1948.

Source: OASD (Comptroller), FAD-397, 28 M arch 1961.

DEPARTMENT OF DEFENSE

Percentage Distribution of Expenditures by Functional Title
Fiscal Years 1953-1962
(Military Functions Only)

Functional Title	Fiscal Year 1953	Fiscal Year 1954	Fiscal Year 1955	Fiscal Year 1956	Fiscal Year 1957	Fiscal Year 1958	Fiscal Year 1959	Fiscal Year 1960	Fiscal Year 1961	Fiscal Year 1962
Total Expenditures	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Military Personnel	27.9	28.9	32.1	32.4	29.7	29.7	28.6	28.5	28.8	28.4
Operation and Maintenance	23.0	22.7	22.3	23.5	24.7	25.0	25.2	24.8	24.6	24.7
Procurement	39.7	39.6	36.1	34.2	35.1	36.1	34.9	34.7	33.7	33.9
Research, Development, Test and Evaluation	4.9	5.4	6.4	5.9	6.3	6.4	7.0	9.1	10.1	10.7
Military Construction	4.4	4.3	4.8	5.8	5.1	4.5	4.7	3.9	3.6	2.8
Revolving & Management Funds	-*	-.9	-1.7	-1.7	-.8	-1.7	-.4	-1.0	-.7	-.5

* Less than .1%

Detail may not add to totals due to rounding.

NOTE: Data are based on order of magnitude estimates which assume that the Fiscal Year 1961 Budget structure had been adopted circa 1948.

Source: OASD (Comptroller), FAD-397, 28 March 1961.

DEPARTMENT OF DEFENSE

Unliquidated balances of progress payments and advance payments compared with guaranteed loans outstanding, fiscal years 1957, 1958, 1959, 1960 and 1961.

(Millions of Dollars)

Fiscal Year	Unliquidated balances of progress payments	Unliquidated balances of advance payments	Guaranteed loans outstanding
1957 - July	4,280.8	33.0	344.2
August	3,885.6	29.5	330.9
September	3,888.8	29.4	349.3
October	3,929.9	35.3	343.4
November	3,930.9	29.6	354.3
December	3,816.8	44.0	367.7
January	3,853.7	46.1	378.4
February	3,957.2	42.8	375.9
March	3,915.8	39.5	385.8
April	4,025.4	54.8	377.4
May	4,103.1	49.4	379.4
June	4,045.5	40.2	383.4
1958 - July	4,037.6	55.2	378.5
August	4,102.9	53.6	354.8
September	4,070.4	46.9	358.4
October	4,056.1	57.8	360.0
November	4,075.1	48.7	353.2
December	3,897.0	43.9	351.3
January	3,789.1	52.9	332.5
February	3,709.8	48.5	322.2
March	3,625.2	45.2	315.6
April	3,481.3	54.7	292.9
May	3,440.1	51.1	275.3
June	3,297.4	44.5	276.2
1959 - July	3,237.9	47.1	247.7
August	3,214.6	48.6	246.0
September	2,860.9	48.4	245.1
October	2,733.2	51.7	251.6
November	2,626.7	48.1	251.1
December	2,640.9	47.9	259.1
January			273.2
February			278.6
March	2,625.5	50.5	286.0
April			266.4
May			265.6
June	2,200.5	36.0	270.9

DEPARTMENT OF DEFENSE

Unliquidated balances of progress payments and advance payments compared with guaranteed loans outstanding, fiscal years 1957, 1958, 1959, 1960 and 1961.

(Millions of Dollars)

Fiscal Year	Unliquidated balances of progress payments	Unliquidated balances of advance payments	Guaranteed loans outstanding
1960 - July			277.1
August			285.0
September	2,256.6	41.5	298.4
October			296.5
November			299.0
December	2,188.9	36.9	298.0
January			
February			
March	2,343.2	40.6	316.7
April			
May			
June	2,357.6	43.6	267.8
1961 - July			
August			
September	2,334.6	44.3	254.5
October			
November			
December	2,462.2	43.7	261.4

Note: Beginning with calendar year 1959, reporting was continued on a quarterly basis only.

Prepared by the Economic Advisor, OASD (Comptroller), Department of Defense.

24 February 1961

DEPARTMENT OF DEFENSE

Unliquidated balances of progress payments and advance payments compared with guaranteed loans outstanding, fiscal years 1957, 1958, 1959, 1960 and 1961.

(Millions of Dollars)

Fiscal Year	Unliquidated balances of progress payments	Unliquidated balances of advance payments	Guaranteed loans out-standing
1957 - July	4,280.8	33.0	344.2
August	3,885.6	29.5	330.9
September	3,888.8	29.4	349.3
October	3,929.9	35.3	343.4
November	3,930.9	29.6	354.3
December	3,816.8	44.0	367.7
January	3,853.7	46.1	378.4
February	3,957.2	42.8	375.9
March	3,915.8	39.5	385.8
April	4,025.4	54.8	377.4
May	4,103.1	49.4	379.4
June	4,045.5	40.2	383.4
1958 - July	4,037.6	55.2	378.5
August	4,102.9	53.6	354.8
September	4,070.4	46.9	358.4
October	4,056.1	57.8	360.0
November	4,075.1	48.7	353.2
December	3,897.0	43.9	351.3
January	3,789.1	52.9	332.5
February	3,709.8	48.5	322.2
March	3,625.2	45.2	315.6
April	3,481.3	54.7	292.9
May	3,440.1	51.1	275.3
June	3,297.4	44.5	276.2
1959 - July	3,237.9	47.1	247.7
August	3,214.6	48.6	246.0
September	2,860.9	48.4	245.1
October	2,733.2	51.7	251.6
November	2,626.7	48.1	251.1
December	2,640.9	47.9	259.1
January			273.2
February			278.6
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April			266.4
May			265.6
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DEPARTMENT OF DEFENSE

Unliquidated balances of progress payments and advance payments compared with guaranteed loans outstanding, fiscal years 1957, 1958, 1959, 1960 and 1961.

(Millions of Dollars)

Fiscal Year	Unliquidated balances of progress payments	Unliquidated balances of advance payments	Guaranteed loans outstanding
1960 - July			277.1
August			285.0
September	2,256.6	41.5	298.4
October			296.5
November			299.0
December	2,188.9	36.9	298.0
January			
February			
March	2,343.2	40.6	316.7
April			
May			
June	2,357.6	43.6	267.8
1961 - July			
August			
September	2,334.6	44.3	254.5
October			
November			
December	2,462.2	43.7	261.4

Note: Beginning with calendar year 1959, reporting was continued on a quarterly basis only.

Prepared by the Economic Advisor, OASD (Comptroller), Department of Defense.

24 February 1961

Department of Defense Net Expenditures for Procurement and Research, Development, Test and Evaluation Compared With Sales, Changes in Unfilled Orders, and Inventories in the Durable Goods Industries

(Billions of Dollars)

Fiscal Year	Department of Defense Net Expenditures for Procurement Research, Development, Test and Evaluation	Durable-Goods Industries		
		Sales	Quarterly Changes in Unfilled Orders	Quarterly Changes in Inventories
1951 - Total	4.74	122.02		
1st quarter	.76	28.21		
2d quarter	.85	30.19	+ 4.12	+1.84
3d quarter	1.33	31.44	+18.04	+1.48
4th quarter	1.80	32.18	+ 7.12	+1.92
1952 - Total	12.64	124.64		
1st quarter	2.15	29.22	+ 4.54	+1.40
2d quarter	2.66	31.66	+ 2.26	+1.25
3d quarter	3.41	31.65	+ 3.67	+1.13
4th quarter	4.43	32.10	+ 3.55	- .13
1953 - Total	18.54	144.29		
1st quarter	3.71	30.82	+ 3.75	- .41
2d quarter	4.63	36.64	- 1.94	+1.03
3d quarter	4.63	37.48	+ .40	+1.03
4th quarter	5.56	39.35	- 2.34	+ .63
1954 - Total	17.34	140.40		
1st quarter	4.61	36.62	- 6.56	+ .11
2d quarter	4.18	35.06	- 7.62	+ .08
3d quarter	4.44	34.05	- 4.92	- .64
4th quarter	4.11	34.68	- 5.20	-1.03
1955 - Total	14.36	142.84		
1st quarter	3.29	31.58	- 1.94	-1.16
2d quarter	3.72	34.03	- .92	+ .68
3d quarter	3.84	37.01	+ 2.01	+ .06
4th quarter	3.51	40.22	+ .53	+ .23
1956 - Total	13.67	163.09		
1st quarter	3.40	38.48	+ 3.04	+ .95
2d quarter	3.29	41.23	+ 3.71	+1.29
3d quarter	3.27	40.76	+ 2.28	+1.20
4th quarter	3.72	42.62	+ 1.69	+ .89
1957 - Total	15.34	169.85		
1st quarter	3.01	38.48	+ 3.15	+ .69
2d quarter	3.96	43.81	+ .53	+1.21
3d quarter	4.04	43.37	- .67	+ .85
4th quarter	4.33	44.19	- 3.18	+ .84
1958 - Total	16.42	154.85		
1st quarter	3.97	41.23	- 3.99	- .44
2d quarter	3.96	41.12	- 5.05	- .17
3d quarter	3.96	36.03	- 3.07	- .97
4th quarter	4.53	36.47	- 1.37	-1.47
1959 - Total	17.14	166.16		
1st quarter	3.83	35.88	- .11	- .95
2d quarter	4.46	40.21	+ .43	+ .13
3d quarter	4.24	41.87	+3.24	+1.24
4th quarter	4.61	48.19	- .27	+1.10
1960 - Total	17.91	175.93		
1st quarter	4.28	40.96	+ .87	- .62
2d quarter	4.72	43.07	+ .28	+ .66
3d quarter	4.41	45.91	- 1.85	+1.80
4th quarter	4.51	45.99	- 1.78	+ .12
1961 - Total				
1st quarter	4.29	41.72	+ .18	- .61
2d quarter (preliminary)	4.79	42.65	- 1.55	- .60

NOTE: Department of Defense net expenditures for procurement and research, development, test and evaluation include (1) the purchase of major items of equipment such as aircraft, missiles, ships, tanks, vehicles, ammunition, weapons, artillery, electronics, etc., and (2) the support of basic and applied research, general technical development, development of new weapons and equipment, fabrication and procurement of items under development for test and evaluation and the operation and maintenance of laboratories and test facilities. These data exclude the purchase of soft goods such as subsistence, petroleum products and clothing, and organizational equipment and supplies. Amounts will not necessarily add to totals due to rounding.

Source: Department of Defense quarterly expenditure data for fiscal years 1951-53 are estimates. Annual figures for fiscal years 1951-53 and all figures for fiscal years 1954-61 are from the Department of Defense: Monthly Report on the Status of Funds. Durable goods industries series (unadjusted) are from the Department of Commerce: Survey of Current Business.

Prepared by the Economic Advisor, OASD(Comptroller), February 27, 1961

Department of Defense Obligations (Orders) for Procurement and Research, Development, Test and Evaluation Compared With New Orders, Unfilled Orders and Inventories in the Durable Goods Industries

(Billions of Dollars)

Fiscal Year	Defense Obligations for Procurement, Research Development, Test & Evaluation	Durable-Goods Industries: New Orders Received	Unfilled Orders: End of Quarter	Unfilled Orders: Changes from Previous quarter	Inventories: End of Quarter	Inventories: Changes from Previous Quarter
1951 - Total	22.96	154.50				
1st quarter	3.72	35.92	28.07		14.93	
2d quarter	3.95	34.17	32.19	+ 4.12	16.77	+1.84
3d quarter	7.83	45.12	50.23	+18.04	18.25	+1.48
4th quarter	7.46	39.30	57.35	+ 7.12	20.17	+1.92
1952 Total	30.21	138.66				
1st quarter	6.19	33.75	61.88	+ 4.54	21.57	+1.40
2d quarter	5.80	33.92	64.14	+ 2.26	22.82	+1.25
3d quarter	7.25	35.32	67.81	+ 3.67	23.94	+1.13
4th quarter	10.97	35.66	71.37	+ 3.55	23.81	- .13
1953 Total	20.21	144.16				
1st quarter	8.89	34.57	75.11	+ 3.75	23.40	- .41
2d quarter	3.84	34.70	73.18	- 1.94	24.43	+1.03
3d quarter	4.45	37.89	73.58	+ .40	25.46	+1.03
4th quarter	3.03	37.01	71.24	- 2.34	26.08	+ .63
1954 Total	5.58	116.10				
1st quarter	.86	30.24	64.68	- 6.56	26.19	+ .11
2d quarter	.42	27.25	57.06	- 7.62	26.27	+ .08
3d quarter	1.12	29.13	52.14	- 4.92	25.63	- .64
4th quarter	3.19	29.48	46.94	- 5.20	24.61	-1.03
1955 Total	10.93	143.03				
1st quarter	2.50	30.15	45.00	- 1.94	23.45	-1.16
2d quarter	4.49	33.11	44.08	- .92	24.13	+ .68
3d quarter	1.68	39.02	46.09	+ 2.01	24.20	+ .06
4th quarter	2.26	40.75	46.62	+ .53	24.43	+ .23
1956 Total	14.45	173.84				
1st quarter	.82	41.52	49.66	+ 3.04	25.38	+ .95
2d quarter	3.28	44.95	53.37	+ 3.71	26.66	+1.29
3d quarter	4.52	43.04	55.65	+ 2.28	27.87	+1.20
4th quarter	5.83	44.34	57.33	+ 1.69	28.76	+ .89
1957 Total	16.19	169.68				
1st quarter	4.13	41.63	60.49	+ 3.15	29.45	+ .69
2d quarter	4.44	44.34	61.02	+ .53	30.66	+1.21
3d quarter	3.98	42.70	60.34	- .67	31.51	+ .85
4th quarter	3.65	41.01	57.16	- 3.18	31.75	+ .24
1958 Total	18.71	141.37				
1st quarter	2.51	37.25	53.18	- 3.99	31.31	- .44
2d quarter	4.33	36.06	48.13	- 5.05	31.14	- .17
3d quarter	5.14	32.97	45.06	- 3.07	30.16	- .97
4th quarter	6.73	35.09	43.69	- 1.37	28.70	-1.47
1959 Total	19.51	169.45				
1st quarter	3.03	35.78	43.58	- .11	27.75	- .95
2d quarter	5.81	40.64	44.01	+ .43	27.87	+ .13
3d quarter	4.77	45.11	47.24	+ 3.24	29.12	+1.24
4th quarter	5.91	47.93	46.98	- .27	30.22	+1.10
1960 Total	17.59	173.46				
1st quarter	3.41	41.83	47.85	+ .87	29.60	- .62
2d quarter	4.40	43.35	48.13	+ .28	30.26	+ .66
3d quarter	4.05	44.07	46.28	- 1.85	32.06	+1.80
4th quarter	5.72	44.21	44.50	- 1.78	32.18	+ .12
1961 Total						
1st quarter	5.18	41.90	44.68	+ .18	31.57	- .61
2d quarter	4.53	41.10	43.13	- 1.55	30.97	- .60

NOTE: Department of Defense net obligations for procurement and research, development, test and evaluation include (1) the purchase of major items of equipment such as aircraft, missiles, ships, tanks, vehicles, ammunition, weapons, artillery, electronics, etc., and (2) the support of basic and applied research, general technical development, development of new weapons and equipment, fabrication and procurement of items under development for test and evaluation and the operation and maintenance of laboratories and test facilities. These data exclude obligations for soft goods such as subsistence, petroleum products and clothing, and organizational equipment and supplies. Amounts will not necessarily add to totals due to rounding.

Source: Department of Defense quarterly obligations data for fiscal years 1951-53 are estimated. Annual figures for fiscal years 1951-53 and all figures for fiscal years 1954-61 are from the Department of Defense: Monthly Report on the Status of Funds. Durable goods industries series (unadjusted) are from the Department of Commerce: Survey of Current Business. Prepared by the Economic Advisor, OASD (Comptroller), February 27, 1961.

The CHAIRMAN. I would like to ask you a few questions.

Since I am on the Small Business Committee of the House I have been watching with interest the expenditures of the Defense Department for research and technological development. If my information is correct, out of the enormous amount—you have granted for such purposes—and I do not say it was too much, but it was quite large as you know—small business concerns in 1956 received 5.7 percent of it; in 1957, 4.3 percent; 1958, 3.7 percent; 1959, 3.5 percent; and in 1960, 3.4 percent.

Do those figures coincide with your information on the subject?

Mr. HITCH. I do not have those figures with me.

Mr. Bannerman, do you have those?

Mr. BANNERMAN. Yes, Mr. Chairman, those I think are taken directly from our report.

The CHAIRMAN. And they are correct figures?

Mr. BANNERMAN. Yes.

The CHAIRMAN. I believe you said an effort will be made to increase the share of procurement contracts awarded to small business, is that correct?

Mr. HITCH. That is right.

The CHAIRMAN. And you expect to increase this figure considerably if you can?

Mr. HITCH. How much of the increase will be in procurement and how much in construction and how much from R.D.T. & E. I do not know, but our intention is to increase the total amount by at least 10 percent.

The CHAIRMAN. As to the share of the contracts awarded to small business I have a figure of 25.3 percent for 1954; 1955, 21.5 percent; 1956, 19.6 percent; 1957, 19.8 percent; 1958, 17.1 percent; 1959, 16.6 percent; and 1960, 16.1 percent, going down, I believe, every year.

Are those figures correct according to your books?

Mr. HITCH. To the best of my knowledge they are.

Mr. BANNERMAN. Those figures are correct, Mr. Chairman.

Mr. HITCH. They sound very correct to me.

The CHAIRMAN. You have room for improvement, I am sure. In your statement, you mentioned about the "expenditures abroad from the regular Defense Department budget down as follows." Are these expenditures in countries, most of them, where they have counterpart funds?

Mr. HITCH. I think most of them are not in countries with counterpart funds.

The CHAIRMAN. Would you say 50 percent, 25 percent?

Mr. HITCH. Yes, the great bulk of them are in West Europe, Canada, and Japan.

The CHAIRMAN. And not counterpart fund countries?

Mr. HITCH. Not counterpart fund countries.

The CHAIRMAN. Has an effort been made to use counterpart funds where they are deposited?

Mr. HITCH. Yes, and they are used to some extent.

The CHAIRMAN. Do you know approximately the total counterpart funds that are available now, on deposit to the credit of the U.S. Government?

Mr. HITCH. I do not have that number with me but we can certainly provide it.

The CHAIRMAN. Is it somewhere around $2 billion or $3 billion, or more?

Mr. HITCH. I could not safely say, sir. We think it is a little over $2 billion but we will find the figure and put it in the record.

The CHAIRMAN. Put it in the record.

Can you break it down to countries?

Mr. HITCH. Yes, sir. There is no problem there.

(The information follows:)

According to the Treasury Department, at the end of fiscal year 1960 the United States had in its accounts approximately $2,450 million equivalent of foreign currencies acquired under various agreements, such as "counterpart" of economic aid under the mutual security program: sales proceeds under the Agricultural Trade, Development and Assistance Act, (Public Law 480); and repayments on loans (Development Loan Funds, etc.).

Of this amount, the largest portion was generated by the Public Law 480 program and accounted for about $2,010 million as of June 30, 1960. Also, under the terms of the agreements which generated them, the majority of these funds are to be returned to the country from which acquired in the form of grants and loans. For example, of the Public Law 480 agreements, concluded through June 30, 1960, only about 30 percent of the sales proceeds are for U.S. use.

In addition, of the amounts which have been accumulated for U.S. use, the vast majority are in countries such as Poland, Yugoslavia, India, Pakistan, Israel, and the United Arab Republic, in which the DOD has relatively few requirements.

NOTE.—The committee staff has been furnished with Treasury Department report, "Foreign Currencies in the Custody of the United States," as of June 30, 1960 which provides information on foreign currency holdings by country of origin.

The CHAIRMAN. I would like to ask you some questions about identical bidding.

Do you have many questions of identical bids coming before you?

Mr. BANNERMAN. This question does arise occasionally; yes, sir.

The CHAIRMAN. Do you know in what percent of your procurement identical bids predominate?

Mr. BANNERMAN. I could not express that in terms of percentage, Mr. Chairman. I do not know. It happens fairly frequently as I think you know.

The CHAIRMAN. How do you handle the award if all the bids are identical?

Mr. BANNERMAN. Well, we have several practices that are involved there. One is that, if we suspect that these are stemming from collusion or are not independently arrived at, they are reported to the Department of Justice for action by that Department.

As far as making amends are concerned, if the question of collusion is not involved we break the ties in advertised bidding by lot.

The CHAIRMAN. By lot?

Mr. BANNERMAN. Yes, sir.

The CHAIRMAN. Did you ever consider giving it to the smallest company making a bid? There is a good way to do it.

Mr. BANNERMAN. It is by lot except that we do have an order of preference if there are small business ties or ties in labor surplus areas.

The CHAIRMAN. Let me see if I get your explanation straight.

In the event there are three bidders, one that is a large concern, another a smaller concern in a depressed area, and a third which is a very small concern, are those the categories?

Mr. BANNERMAN. I do not understand whether your second category was or was not a small business.

The CHAIRMAN. Well, it could be either small or large but you would give preference to the depressed area?

Mr. BANNERMAN. We give preference as among small business bidders to those who will perform in depressed areas.

The CHAIRMAN. Let us say now that they are all large and one of them is in a depressed area.

Mr. BANNERMAN. We would give him preference.

The CHAIRMAN. Suppose we have all small businesses. The depressed area would come first?

Mr. BANNERMAN. That is correct.

I might add that even within the depressed areas we would give an additional preference to those who are in areas of chronic or persistent labor difficulty.

The CHAIRMAN. The major areas?

Mr. BANNERMAN. Not necessarily major but chronic.

The CHAIRMAN. Suppose it is not a depressed area, not a chronically depressed area, and there is a big and a little concern and they bid exactly the same down to the fifth decimal point. To which would you give it there?

Mr. BANNERMAN. It would be awarded to the small business concern.

The CHAIRMAN. You would give it to the small business concern?

Mr. BANNERMAN. That is correct.

The CHAIRMAN. That is your policy?

Mr. BANNERMAN. Yes, sir.

The CHAIRMAN. Why is it that the contracts placed with small concerns have decreased so substantially? In 1954, 25.3 percent went to small business and last year only 16 percent?

Mr. BANNERMAN. I would like to say a couple of things about that if I may.

No. 1, the amount of tie bids received is an infinitely small percentage of our total. I would doubt if one-half of 1 percent of our bids and probably a great deal less than that is ever resolved on that basis simply because you do not have tie bids in cases involving that many dollars.

I would like to point out that the reduction that you mentioned from 25.3 percent in 1954 to 16.1 percent which has been rather steady, nevertheless starts out with what is far and away the highest year for awards to small business which we have ever had. That was occasioned by the fact that these are net figures and included contract terminations. During 1954 we were terminating some very large contracts with some very large contractors in the ordnance business right after Korea and the result is that the net figures to small business for that year were high. The preceding year was 16.6. Fiscal 1952 was 17 and fiscal 1951 was 20.9, so that, while I do not deny for a moment that the trend has been down, nevertheless 1954 was an unusual year.

The CHAIRMAN. Did you say that this percentage related to the number of contracts and not the dollar amount?

Mr. BANNERMAN. Total dollars.

The CHAIRMAN. Dollar amounts?

Mr. BANNERMAN. The contract dollars.

The CHAIRMAN. Yes.

Are a lot of your negotiated bids identical too?

Mr. BANNERMAN. I would say that it is quite rare for us to get identical bids in a negotiated procurement and, even if we got them, of course that it not the end of it because that starts the negotiation and there is no telling what they will be when they are through.

The CHAIRMAN. You do not have to accept them, of course.

Mr. BANNERMAN. That is correct.

The CHAIRMAN. Do you have any definite way of stopping this identical bidding?

Mr. BANNERMAN. No. Our only procedure and practice up to the present time is to take those on which we have some basis for suspecting collusion and report them, along with our basis for suspecting it, to the Department of Justice. There are pending at the moment, as you know, certain items of legislation on this subject.

The CHAIRMAN. Yes, sir; and I suspect there will be an Executive order.

Mr. BANNERMAN. I think so. The President, I think, said that there will be.

The CHAIRMAN. Yes, sir.

Mr. Curtis?

Representative CURTIS. First, Mr. Chairman, I want to express my real appreciation to Secretary Hitch and his staff for this statement. I do not know that we have ever had anything like this and it is the kind of information that I feel that we have needed for a long time.

Getting back to the Standard Industrial Classification Code, is there any way that you see where you can break that down or set it up in a way that we can get at these figures?

Mr. HITCH. Well, sir; I just have not had an opportunity to go into that yet. I think that perhaps what we ought to do is to get this classification modified and modernized. It has a very old-fashioned ring now. I think it has not been adjusted to changes in technology and they are trying to force some new items of equipment into old baskets.

Representative CURTIS. What you have given us already is such interesting data and has such a bearing on some of the things that have been occurring in our economy that I am going to do quite a bit of thinking about it in order to evaluate it.

Mr. HITCH. We would like to do some thinking about what could be done with this classification to get it into terms that are more meaningful and useful.

Representative CURTIS. I might make the remark that in the beginning you talk about the acceleration and expansion of the Defense program. Those things are fine. It is when we are cutting back on programs, though, that we are creating the negative factor.

Of course, one thing that we are cutting back on is the B–70 program.

So we have to evaluate that along with the other.

How much unemployment will be created there?

Mr. HITCH. I am well aware of this, sir. I come from the area which will be most affected by that cutback.

Representative CURTIS. These statistics that you have given us and the ones that you are going to continue to develop will not give us the information on what is going to happen geographically.

Mr. HITCH. No, sir. They do not, and that is extremely difficult for us to do.

Representative CURTIS. Yes, I imagine that it is although there is a lot of work now being done in other areas on what they call regional accounting and the more I look into that the more I realize that, when we get down to what causes this or that, it is the regions that become important.

Mr. HITCH. But in this case it is particularly difficult for us to make any estimates regarding the future because of competitive bidding and because of subcontracting.

Representative CURTIS. Even if you could, I do not know that there would be anything that you could do about it because I think your guideline has to be, as I read and I am glad you kept emphasizing it, your consideration must be defense; and it is only in a very limited way that you can even pay attention to such things as small business and depressed areas.

Mr. HITCH. That is my view; yes, sir.

Representative CURTIS. It certainly is my view, too.

On this small business problem, those are prime contracts, are they not, when we are talking about percentages?

Mr. HITCH. Yes.

Representative CURTIS. However, equally important, and I want to get your policy on that, would be the amount of subcontracting that the prime contractor does because we have found in many instances and I know Congressman Patman in his Small Business Committee has observed that a big company can establish a new division to take care of it or they can subcontract it out.

I wonder if you would state just in a few words what the policy is on subcontracting and what we know about it in figures?

Mr. HITCH. I would like again to call on Mr. Bannerman to answer this question on contracting policy.

Mr. BANNERMAN. I might say, Mr. Curtis, that we get reports on the extent of first tier subcontracting by close to 300 of our major primes and those reports indicate that the dollars flowing into small business at the first tier subcontract level are approximately the same, year after year, as the amount the small businesses are getting as primes.

In other words, 16.1 percent in fiscal 1960 went to small business as primes. Between 15 and 20 percent also went, in addition, to them as subs at the first tier level.

We do have a very active program that has been adopted in our regulations within the last year and which I am sure will require very careful administration to assure that our prime contractors, particularly those who are dealing in very large contracts, give every opportunity for competition, the same opportunity substantially as we do, to small businesses to compete for their subcontracts.

This program is spelled out in the large prime contracts.

We have what we call a mandatory small business subcontracting program that we incorporate by contract provision in all major primes, that is to say all primes over a million dollars, and we put them also into certain smaller primes.

Representative CURTIS. Do you find any resistance on that by the bigger prime contractors?

Mr. BANNERMAN. We have found absolutely no resistance to the acceptance of the contract clause. I assume that there is considerable unevenness in the vigor with which this is pursued by the primes.

I think that, as time wears on, it will be increasingly well handled.

Representative CURTIS. Yes.

I have one other comment on the acceleration program which you described here. That is an area which sounds like just good business practice for, I might say, the Government as a purchaser to take advantage of a slack and to move up expenditures. I think business does do that, too, would you not say?

Mr. HITCH. Yes, sir. I would indeed.

Representative CURTIS. There is one thing where the Defense expenditure can be doing a job to help the economy in a recession which conforms to good business practice and I daresay you get better prices for it, too, unlike these other two areas where I think you are somewhat in conflict with the efficiency of your end result.

Mr. HITCH. Yes, sir; at least in the short run.

Representative CURTIS. I have some other questions but I will come back.

The CHAIRMAN. Mr. Bolling?

Representative BOLLING. I have no questions, Mr. Chairman.

The CHAIRMAN. May I say the small business explanation you gave a moment ago is very heartening to me. It occurs to me that, if you carry out this policy in this expanded program, small business concerns are going to get a real opportunity to obtain a fair share of your orders.

If I understand now, if two concerns bid and one is in a distressed area and one is not, say if they are both large or both small, the one in the distressed area gets it, of course?

Mr. BANNERMAN. That is correct.

The CHAIRMAN. If two businesses bid and one is large and one small, regardless of whether it is a distressed area or not the smaller one gets it.

Mr. BANNERMAN. That is correct.

The CHAIRMAN. Where there are two identical bids, one large and one small, the smaller one gets it?

Mr. BANNERMAN. That is correct.

The CHAIRMAN. I am very much heartened by that statement of policy.

Mr. BANNERMAN. This policy is spelled out in our regulations. I would like to make it very clear that a tiny percentage of our total procurement is affected by this policy since it relates only to bids where the low bids are tied.

The CHAIRMAN. Senator Proxmire?

Senator PROXMIRE. Is it not likely to be even tinier with the anticipated President's order about identical bids too?

Mr. BANNERMAN. Senator, I would be guessing. I think this might be possible. I think we all recognize that there are identical bids received that have nothing to do with collusion.

Senator PROXMIRE. It is pretty hard for us to imagine a situation where you have identical bids independently arrived at to the fifth decimal point in which there is not some collusion.

I take it that this only pertains to advertised competitive bids and certainly the whole purpose of advertised competitive bids is destroyed if contractors come in with precisely identical bids.

Mr. BANNERMAN. Senator, I agree that it does relate to only advertised bids but I point out that there are a number of industries where bidding is on the basis of published or posted prices and there have been a half dozen investigations of these situations over the last 20 years in a number of industries to no result.

Senator PROXMIRE. Mr. Hitch, I read your book yesterday, the "Economics of Defense in the Nuclear Age," and I must say I am enormously impressed.

Congressman Curtis commended you on the usefulness of this report.

I must say that, as a new Member of the Senate, I have read very few things of equal value because I have been baffled and frustrated by the enormous budget that comes in each year in which I can find no criteria on which to base my vote on the bill or amendments to it.

I am sure you do not think this is the complete answer but it is mighty useful to me.

In your statement I understand you to say that "President Kennedy's proposed revisions to the fiscal year 1962 defense program and budget," and so forth, "are based solely on national security considerations," solely.

Mr. HITCH. Yes.

Senator PROXMIRE. Do you mean that there is no relationship to how much we can afford to spend on defense?

Mr. HITCH. No, sir. I would not say that.

Senator PROXMIRE. I would interpret this as meaning the only consideration was what he thought we needed and, regardless of what it cost, this was it. In other words, I have in mind the criticism that was made by many of the Eisenhower defense program as being budget motivated and budget dominated and budget determined.

I want to know if this represents a clear departure from that or if this simply means that you did think of the cost but in some kind of a subordinate way?

Mr. HITCH. I am sorry. This statement is perhaps not as clear as it should be. What I meant was that in thinking about what we would get from these recommended accelerations we were thinking about the gains to national security. We were not thinking only about the extent to which we could help a depressed area. I did not mean to say that we did not take the cost into account.

President Kennedy and the Secretary of Defense certainly had in their minds the fact that there is a cost and that when we increase defense this means that we have less for other purposes. This is something that you do have to take into account and this does limit to some extent what you can spend on defense.

Senator PROXMIRE. I take it that in fact budget cost was a very important consideration.

Mr. HITCH. Yes, sir; it was important. I will say that there was no arbitrary figure determined in advance as to how much additional could be spent on defense. The fact that any increase does involve cost was certainly given very serious consideration.

Senator PROXMIRE. Especially in view of the fact that the President has been very sympathetic with the recommendations of the Rockefeller Committee and of the Gaither Committee, at least as published, and those were for a defense budget of $53.2 billion for 1961 in the case of the Rockefeller and even higher for the Gaither Committee, as I recall.

I take it, in view of the fact that the President is recommending far, far less and much closer to the Eisenhower budget, that cost considerations were of considerable significance to him?

Mr. HITCH. There were two things that were of considerable significance, I think. One was cost considerations. The other was that this budget review had to be done in a very short time. It was, therefore, addressed to the most urgent problems, the most urgent changes in emphasis which we thought were necessary, and I do not think too much can be read into this as to the total of the defense budget in future years.

We will be able to make a much more thorough review of the defense budget for 1963.

I am not predicting that it will be higher, but it might be.

Senator PROXMIRE. At least one of the elements that might have led you to come in with a more ambitious and substantial budget will not inhibit you in the 1963 budget. That is the time to work it out and plan it more carefully.

Mr. HITCH. Yes, sir. That was my point.

Senator PROXMIRE. I take it also that there might be a supplemental request for the 1962 budget that might increase that, too.

Mr. HITCH. This is possible.

Senator PROXMIRE. Now, in your book you rely on gross national product as a limitation on defense spending. It is true you do refer to the gross national product occasionally in terms of full employment but most of the analysis is concerned with the GNP, whatever it is, period. At least, that is the way I seem to find out.

We just had an opinion by the President's principal economic advisers that heavy unemployment and empty factory capacity can be expected to be a concomitant of our economy for a long time. With 5 million out of work and one-quarter to one-half of our factory capacity idle the $50 billion more of GNP necessary before we begin to strain our economy should not this modify your attitude quite drastically?

Mr. HITCH. Sir, I have not read this book for several months so that I am speaking from memory but my recollection is that whenever I spoke of GNP as being a limiting factor I was referring to full employment GNP and not the actual GNP.

Senator PROXMIRE. Good, because I want to make a very, very important distinction. You have told us, and the President has made it clear and the Budget Director has made it clear, that this is not and will not be an attempt to achieve economic stability.

I want to make a distinction between that and the overall judgment that our economy may be slack, may have unused resources, may have heavy unemployment, and may have vacant factory capacity for a long, long time, not a matter of a few months but perhaps for years.

Therefore, would not this modify your judgment as to how large a defense budget we could afford to have in terms of the allocation of resources that are otherwise being wasted?

Mr. HITCH. Yes, sir. If things did turn out that way that would modify my judgment

Senator PROXMIRE. Well, the principal economic adviser to the President certainly did not give me much optimism about what we can expect as far as the employment picture is concerned.

I am sure other members of the committee have other viewpoints but I suggest that you might look that over and consider it because as the principal economic adviser to the President, his advice is about as authenticative as you can get in the economics field.

Mr. HITCH. Yes, sir.

Senator PROXMIRE. In your statement you say:

> * * * We have sought wherever feasible and sensible, to accelerate the placement of contracts for programs already approved. In this case, however, we are simply buying the same things, or doing the same things, somewhat earlier than we had originally planned.

Now, I am a little puzzled about this because both the President and the Budget Director, as I say, have specifically excluded defense from this speed up category and yet you come in and point out to us that the defense forward buying or acceleration of obligations constitutes about one-fourth, $150 million out of $660 million of the acceleration.

Is that not a departure from what the President told the country he intended to do?

Mr. HITCH. No, sir. We were not excluded from this accelerated procurement instruction.

Senator PROXMIRE. I wish I had brought in his precise language because I think this excluding the Defense Department was very clear. He singled you out, it seems to me, in his message. He said that the defense would not be involved in this, but I will see if I can dig that up.

Mr. HITCH. No, sir. I clearly recollect that we were asked to participate.

Senator PROXMIRE. In view of the long-range expectation of unemployment, probably a year or maybe much more, I am wondering how you justify moving back into the current quarter these additional obligations in view of these facts: No. 1, your statement has told us that there will be an additional $700 million for fiscal 1961 on top of what was going to be spent before, and as I understand it this has to be spent very largely in this current quarter.

In addition to this, you say, and I quote:

> On the basis of President Kennedy's revised budget, gross obigations in 1961—the current fiscal year—are expected to total almost $48 billion, about $5.5 billion more than fiscal year 1960 and about $3 billion more than fiscal year 1959.

Then you go on to say that it will be bigger than the Korean war buildup and point out that this is the peak.

You are pouring more obligations into April, May, and June of this year coming up.

In addition you are increasing the obligations by borrowing from the future.

In view of the fact that this is long-range unemployment, are you not creating a situation in which we are likely to have a little boom now, a little gain in the economy, at the expense of unemployment at a later period?

Mr. HITCH. Well, sir, that is very hard to say. This depends upon the extent to which we get increased obligational authority next year.

Actually, these increases in obligations in fiscal year 1961 relate primarily to the expansion in the Polaris program and in the airlift program, and in order to get expenditures in 1962 we have to incur the obligations in the year 1961. The borrowing in the accelerated program actually is from future years. This acceleration in which we participated is estimated to increase expenditures slightly in 1962, as well as in 1961.

The net borrowing is from years after 1962.

Senator PROXMIRE. It seems that your analysis in your statement and in your book, too, indicate that obligations, orders are very important in the economy in putting people to work, and it would seem to me that they are more important than actual expenditures which are paying for work that has been done so that the fact that these orders come this quarter would seem to me to concentrate a tremendous burst of activity on the economy in these 3 months perhaps at the expense of a later period.

Mr. HITCH. I doubt if the effect will be that immediate. But it seems to me that one thing is clear, sir, and that is that we know that we want acceleration this quarter and this year.

Now, the President's principal economic adviser may estimate, he may believe that we will also want to stimulate it a year from now or 2 years from now, but that is a prediction, and predictions of this kind as we know are subject to error even if they are authoritative predictions.

We do know that we want to stimulate the economy this quarter and this year and that is what taking these particular moves will tend to do.

What we will do by way of incurring new obligations in fiscal year 1962 is something that is still subject to our control and by "our" I mean the Defense Department's, the President's, and the Congress control.

Senator PROXMIRE. Thank you, Mr. Chairman. I will come back to this.

The CHAIRMAN. Mrs. Griffiths.

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

In your statement you point out that the nonproductive employees in the aircraft industry have increased while the productive employees have gone down. Do you count presidents, vice presidents, secretaries, treasurers, stenographers, and so on, as not productive employees?

Mr. HITCH. Yes, they are all counted as nonproduction.

Representative GRIFFITHS. Then may I ask, are you capable, in a bid that the aircraft industry makes, of determining whether or not the cost of employing these people is fairly counted in in the price of the bid?

Mr. HITCH. Could I ask Mr. Bannerman to comment on the way in which this is done?

Mr. BANNERMAN. The bulk of the work in the aircraft and missile business, by virtue of its experimental and developmental nature these days, is being done under some kind of contract involving cost reimbursement usually. Those contracts are all subject to exact audit, and salaries of the type you described are audited very carefully indeed in both evaluating proposals and in actually making payments under such contracts.

I think that it is safe to say that they are evaluated fairly and that they are audited accurately.

Represententtive GRIFFITHS. Most of these people would be valid employees of other industries. That is, there must be competing industries who would be happy to have such employees. For instance, the aircraft industry is always stealing scientists out of Michigan. The aircraft industry is a subsidized industry. The taxpayers are paying, for all practical purposes, the full bill. So that, if the Government permits the aircraft industry to maintain those people when they are not actually engaged in work or when they are partially engaged, if it permits them to maintain an establishment, we are really subsidizing the aircraft industry against private industry to a greater extent than is generally assumed to be true. That is, it seems to me that, in your very statement that the nonproductive employees have increased as the productive employees have gone down, certainly that has in it some of the element of fact that there is no real criterion for the aircraft industry to get rid of people they do not need. They can hoard labor unless you have a really sharp contracting arrangement. Is that right? I think it is right. I would be glad to hear you say if you think that is not true.

Mr. HITCH. Could I just say that this term "nonproductive" is perhaps a very unfortunate one.

Representative GRIFFITHS. I understand perfectly what you mean. Mr. Hitch. I have no problem at all, no problem at all

Mr. HITCH. I think that this change in the proportion of employees who are not on the production line is one that one would expect with the technological developments that have occurred. We just are not engaged in producing large production quantities of aircraft and missiles.

Representative GRIFFITHS. That is, missiles are practically handmade.

Mr. HITCH. We are handmaking things. We are researching and developing them and making all sorts of engineering changes as we go along and we just do not have a need for the same proportion of people on the production line that we had before, so that I think that the change in this ratio is one that one would expect.

Now, I entirely agree that this is something that has to be scrutinized very carefully. It has to be watched very carefully. It is something that could get out of hand if it were not.

Representative GRIFFITHS. Thank you.

Now I would like to ask you, do you contemplate asking the subcontractors to notify you if they have identical bids from their subs?

Mr. BANNERMAN. You mean prime contractors?

Representative GRIFFITHS. No, primes or subs. First shall we take primes. If the primes have identical bids from subs, do you contemplate asking them to notify you?

Mr. BANNERMAN. Mrs. Griffiths, there is no such practice in contemplation at the moment that I know of.

I think that you are aware of the fact that this problem of identical bids is rather peculiar to formal advertised bidding largely because in formal advertised bidding the bid sets the price whereas in other types of contracting there is always an opportunity to negotiate for some different price from one or more bidders. I think that formally advertised bidding as we know it in Government procurement is almost unknown in corporate buying. Hence, I would assume that, if there were identical bids received at the outset in a subcontract situation, every effort would be made to improve the price from one or more of them.

Representative GRIFFITHS. But you have no method now?

Mr. BANNERMAN. We have no system of reporting them.

Representative GRIFFITHS. It would not be reported to you if it happens?

Mr. BANNERMAN. It would not at the present time be reported to us.

Representative GRIFFITHS. You are not a large purchaser, for instance, of cold rolled steel, are you? You use it but it is bought by primes or subs, right?

Mr. BANNERMAN. I should be a better expert on what we use cold rolled steel for but I think we do use considerable quantities in some of our Government-operated industrial establishments such as shipyards.

Representative GRIFFITHS. But it would not be reported?

Mr. BANNERMAN. You are correct that the big usage would be at the subcontract level.

Representative GRIFFITHS. Yet undoubtedly whether you purchase it from Great Lakes or Bethlehem Steel it is the same price?

Mr. BANNERMAN. I think that is correct.

Representative GRIFFITHS. But this will not come before you for review. You will not turn this over to the Attorney General?

Mr. BANNERMAN. We had, in times past, several instances of identical bidding in prime contracts to us of steel products of that kind. Some of these have been turned over.

Representative GRIFFITHS. Now I would like to say that, in the first place, I feel that competitive bidding is no real guarantee that you are going to get a reasonable price. I never have believed this was true of competitive bidding. I do not believe that you therefore automatically get a reasonable price and I think that the mere fact that you could secure identical bids on many items certainly shows its truth. That is, the sellers have already split up the market to suit themselves.

Now, obviously, it is a very crude arrangement and it can be done equally easily by dividing the market on a percentage basis, a percentage of the dollar volume or some other method where you are selling to the Government, not as easily to the general public.

However, do you anticipate in this order against identical bids that you will be giving an advantage to a totally Government subsidized industry or to one that is selling both to the Government and to the public, or have you considered that?

Mr. BANNERMAN. I do not know that I understand the question, Mrs. Griffiths.

Representative GRIFFITHS. That is, if you are having Boeing Aircraft bid and General Motors and they are compelled to put in a competitive bid, not a bid by agreement, will you be favoring General Motors or Boeing, or do you think that you could determine that?

Mr. BANNERMAN. Do you mean if we receive identical bids from them?

Representative GRIFFITH. No; when you have an order against them they could not make such a bid. Of course, these two companies probably would be in competition but at a lower level they would not be.

Mr. BANNERMAN. I do not know of any order that will prohibit them from filing identical bids, or any proposed legislation. The order and legislation would simply require that it be reported and publicly announced.

Representative GRIFFITHS. That is right.

Mr. BANNERMAN. If we got identical bids from those two companies that you mentioned, the first question we would ask is which is going to perform in a surplus-labor area, and we would proceed that way.

Representative GRIFFITHS. The first thing you are going to do is report to the Attorney General. Therefore, they are not going to put in identical bids any more.

Perhaps I have used an unfortunate selection. Maybe I should have used the electronics companies.

Mr. BANNERMAN. I would not assume that an order requiring reporting of identical bids will stop identical bids.

Representative GRIFFITHS. I think it would. I think two or three more in jail will do it. But, the bidders will achieve the same result in a different way.

I wonder in the meantime which of these companies is in a favored position?

For instance, Ramo-Wooldridge, doing almost 100 percent business with the Government, or Westinghouse, will they put up their overhead on the consumer product or some other product or just what will they do about it?

Mr. BANNERMAN. I think that is impossible to predict.

Representative GRIFFITHS. I think we would have some difficulty in predicting it but I personally believe that some of these people will be more favored than others.

Now I would like to return to Mr. Hitch.

I also read the book and I must say I think you did a remarkably good job. In one of your chapters on purchasing, chapter 12, page 232, you point out that "despite the uncertainties that plague cost estimation, better cost analysis for the military services during negotiation is one important way to improve incentives of contractors and increase their efficiency."

I agree with you. I think the thing that you need in the Government is better purchasers and this is the only way that I think you will ever get a reasonable price.

I have had in this Congress for 6 years a bill numbered this year H.R. 215. All that it would require is that, before the final payment is made by the Government to the prime contractor, he supply certified copies of the invoices that he paid the subs and that the subs paid their subs.

I draw it to your attention. I spent a long time as a purchaser and I know the value that such a thing would have. It has been reviewed on past occasions by the Director of the Budget and by the Secretary of the Defense Department and they have always said that it is impossible to do; they do not have enough manpower. I would like to point out to you that every day General Motors, Ford, Chrysler, and all other big companies know their costs right down to the last penny and it is not inconceivable that the Federal Government could do it likewise.

I hope you will review the bill and I hope that this year I have some chance of seeing it become the law.

Mr. HITCH. I will have a look at it, Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much.

The CHAIRMAN. Senator Pell?

Senator PELL. Mr. Hitch, as a Senator from a State the major portion of which is in an area of severe and persistent unemployment, I was wondering if you could enlarge your thoughts concerning the Department of Defense's "attempt" to maximize the placement of supply contracts in areas currently designated as having labor surplus.

Beyond the technique you have already mentioned of identical bids, what other ways do you have of maximizing placement of contracts in those areas?

Mr. HITCH. We have the "set-asides" for the labor surplus areas. We are not permitted to place contracts in labor surplus areas where there is a cost or price differential. However, where an order can be divided and we can get competitive bids on a part of the order, we can then negotiate the second part of the order with firms in depressed areas and labor surplus areas at prices no higher than in the open competitive bidding for the first part of the order.

Senator PELL. Excuse me. I do not understand. Do you mean that you divide the bid up?

Mr. HITCH. Yes: you divide your total program into two parts, two halves or differently, but frequently two halves. For the first half you have advertised competitive bidding and you place the first half of the order as a result of this advertised competitive bidding. We can now negotiate contracts for the second half of the order with firms in labor surplus areas at the same price. Here we are not paying more to place the contract in the labor surplus area. You cannot do this very often. This is always a small program. You cannot do this very often because it is not often that you can break a program into half in this way without incurring a penalty.

I believe that the total contracts let under this set-aside program last year amounted to something on the order of $30 million.

Senator PELL. And that comes under your office, sir?

Mr. HITCH. The procurement policies and procedures are the major responsibility of the Assistant Secretary for Installations and Logistics.

Senator PELL. Thank you very much.

I have one other question. I was wondering if you knew the ratio of people dependent upon jobs from the viewpoint of military production of aircraft versus civilian production of aircraft. Is it about half and half for the industry?

Mr. HITCH. Oh, no. Military is much more.

Senator PELL. How much more?

Mr. HITCH. Military is about 80 to 90 percent.

Senator PELL. Also, I was wondering in the statement you filed where you mentioned that a review of the previous administration's program showed that one item had to be upgraded another $200 million. Was that because of an increasing expense in the items or was it a change in concept?

Mr. HITCH. No, sir. This is just a review of the expenditure in a given fiscal year resulting from the obligation authority granted in that or previous years. You know the effective control is through obligation authority. The amount that will be expended in any particular year as a result of that obligation authority is just an estimate. Some of these estimates in the past have been quite wide of the mark and for some reason these estimates of expenditure in the January budget appeared to be quite low for both fiscal year 1961 and fiscal year 1962. We know in part why this is so, but for the major part it appears to have been just an underestimate. It was more marked in fiscal year 1961 than in fiscal year 1962.

Senator PELL. Finally, I was wondering if, in your estimate of shipbuilding costs, you took into account the President's message where he called for the 29 Polaris submarines?

Mr. HITCH. Yes, sir.

Senator PELL. That is included in that?

Mr. HITCH. Yes.

Senator PELL. Thank you, sir.

The CHAIRMAN. I have here two task force reports to which reference has often been made in these hearings. One is the Samuelson report on the economy and the other the Sproul Committee report on balance of payments.

Without objection, they will be inserted in the appendix of the hearing for consideration.

The CHAIRMAN. I would like to ask that all material that is to be submitted in connection with these hearings be submitted by Wednesday midnight, including material from you gentlemen, if you please, because the staff has quite a problem getting the material ready for the report on time.

Without objection, we will require that all materials be submitted by that time.

Mr. HITCH. Does this mean the transcript, Mr. Chairman?

The CHAIRMAN. You will get the transcript tomorrow morning early. Could you finish it by the next night, then?

Mr. HITCH. Yes, I see no reason why that cannot be done.

The CHAIRMAN. I would like to suggest one way we might get good prices for the Government. Where you are purchasing standard items, goods that are sold normally to consumers, you could put in the contract a certification to the effect that the price offered the Government is no higher than the price being charged other buyers for like goods in like quantities.

Had you considered a statement like that?

Mr. BANNERMAN. Mr. Chairman, we have not infrequently put such provisions in our contracts where we thought it would be valuable to the Government. We have the flexibility to do so right now.

As you know, we very frequently get prices that are far better than those to others and we would not want to, in the guise of setting a ceiling, set a floor.

The CHAIRMAN. I am glad that you have considered that and have actually put them in some contracts.

Mr. BANNERMAN. We have done this not infrequently particularly where we have to price in a moving market.

The CHAIRMAN. Would you mind putting in the record at this point a copy of the language that you used in certifications of that type?

Mr. BANNERMAN. I will be glad to give you some examples, Mr. Chairman.

The CHAIRMAN. Put them in the record at this point if you please.

(The information follows:)

"MOST FAVORED CUSTOMERS" CLAUSES

The following are examples of "most favored customers" type contract provisions used by the Department of Defense:

BASIC STEEL, ALUMINUM, BRASS, BRONZE OR COPPER MILL PRODUCTS

When an established price exists for the subject products, a clause may be used which contains the following provision:

"The contractor warrants that the unit prices stated herein, excluding any part of the prices which reflects requirements for preservation, packaging, and packing, beyond standard commercial practice, are not in excess of the contractor's applicable established prices in effect on the date set for opening of bids (or the contract date, if this is a negotiated contract rather than one entered into by means of formal advertising) for like quantities of the supplies covered by this contract." (See ASPR 7-106.1, attached.)

STANDARD SUPPLIES

A clause is authorized for negotiated fixed-price supply contracts for standard supplies for which established prices exist, when the total contract price is over $5,000 and delivery is not to be completed within 6 months after the contract date. This clause contains the following paragraph:

"The contractor warrants that the unit prices stated herein, excluding any part of the prices which reflects requirements for preservation, packaging, and packing beyond standard commercial practice, are not in excess of the contractor's applicable established prices in effect on the contract date for like quantities of the supplies covered by this contract. The term 'established price' as used in this clause is the net price after applying any applicable standard trade discounts offered by the contractor from his list or catalog price. (See ASPR 7-106.3, attached.)

SEMISTANDARD SUPPLIES

In negotiated fixed-price contracts for semistandard supplies over $5,000, with deliveries to be completed more than 6 months after the contract date, where the prices can be reasonably related to the prices of nearly equivalent standard supplies for which established prices exist, the following clause may be used:

"The contractor warrants that the supplies covered by this contract are supplies which the contractor customarily offers for sale commercially except for modifications in accordance with the specifications of this contract, and that as of the contract date any differences between the unit prices stated herein and the contractor's established prices for like quantities of the supplies which are the nearest commercial equivalents of the supplies covered by this contract (herein referred to as 'the established prices') are due to compliance with such specifications, and to compliance with any requirements which this contract may contain for preservation, packaging, and packing beyond the standard commercial practice. The term 'established price' as used in this clause is the net price after applying any applicable standard trade discounts offered by the contractor from his list or catalog price." (See ASPR 7–106.4, attached.)

MATERIAL COSTS IN NEGOTIATED CONTRACTS

Our contract cost principles include the following paragraph with respect to material costs:

"Charges for materials, services, and supplies sold or transferred between plants, divisions, or organizations, under a common control, ordinarily shall be allowable to the extent of the lower of cost to the transferor or current market price. However, a departure from this basis is permissible where (i) the item is regularly manufactured and sold by the contractor through commercial channels, and (ii) it is the contractor's long-established practice to price interorganization transfers at other than cost for commercial work: *Provided*, That the charge to the contract is not in excess of the transferor's sales price to his most favored customer for the same item in like quantity, or the current market price, whichever is lower."

In addition to the foregoing, our regulations require approval of contractor's purchasing systems, or approval of subcontracts in many instances, and further require that such approval be based on a number of factors, including "the extent to which the contractor obtains assurance that his principal subcontractors apply sound pricing practices and a satisfactory purchasing system in dealing with lower tier subcontractors." ASPR 3–903.4(b) also provides that in reviewing subcontracts, "careful and thorough evaluation is particularly necessary when * * * a subcontract is being proposed at a price less favorable than that which has been given by the subcontractor to the Government, all other factors such as manufacturing period and quantity being comparable."

SOLE SOURCE ITEMS

ASPR 3–807.6 provides:

"When purchases of standard commercial or modified standard commercial items are to be made from sole source suppliers, use of the techniques of price and cost analysis may not always be possible. In such instances and consistent with the volume of procurement normally consummated with the contractor, the contractor's price lists and discount or rebate arrangements should be examined and negotiations conducted on the basis of the 'best user,' 'most favored customer' or similar practice customarily followed by the contractor. Such price negotiations should consider the volume of business anticipated for a fixed period, such as a fiscal year, rather than the size of the individual procurement being negotiated."

The CHAIRMAN. Mr. Curtis, would you like to ask some questions?

Representative CURTIS. Yes.

Can you give us any indication as to how the costs of particular Defense contracts are changing currently; for example, whether the technological changes are having any effect in reducing cost estimates?

Mr. HITCH. Well, sir, this is a very difficult thing to say because the quality of the defense product changes all the time and changes so rapidly. If the technology of others would just stand still, I think it would be perfectly apparent that advances in our technology could reduce the cost of defense.

Representative CURTIS. That would be true, of course, of your experimental weapons but there is so much procurement that maybe was an innovation at the time but it is not of that nature any longer. For example, the development of the transistors in electronics has certainly brought down unit costs in particular as it became developed.

It is things like that that I was thinking of.

Take the Polaris submarine after your prototype. Of course, that is being improved but eventually the subsequnent versions ought to show some real savings. That is what this question is directed to.

Mr. HITCH. Oh, yes. At that level in particular procurements, yes, indeed, you do have savings.

Representative CURTIS. How is that reflected in the budget, if at all? I am thinking that we vote these moneys and in the course of time from getting the obligation to the time when they are actually produced, particularly when we go into mass production on some of these items, where will there ever be revealed in the budget the fact that there might have been some savings? If there are savings, is it just not transferred and used for something else rather than reported back?

Mr. HITCH. To a considerable extent it is transferred to something else, sir. That is, you always underestimate some things and some other things cost more than you expect them to. You run into unexpected difficulties in a development project and quite a number of savings are shifted into something alse.

Representative CURTIS. Now, in discussing the employment problem, and the statistics which you gave us were most helpful, we have this problem of a lot of new skills being in demand. Has the shortage of these skills slowed down some of this defense procurement? Is there not a real problem of shortage of skills in many areas in the defense procurement field?

Mr. HITCH. Yes, sir. In every one of these new technologies you run into shortage of skills.

Representative CURTIS. At the same time we have this unemployment problem.

Mr. HITCH. At the same time you have big surpluses of unemployment.

Representative CURTIS. That suggest obviously a program of training and retraining.

Mr. HITCH. Yes.

Representative CURTIS. What does the Defense Department do in this area of training and retraining?

Mr. HITCH. This is something that I have not had an opportunity to look into.

Representative CURTIS. I am most anxious, although not for this record obviously, that you tell us what programs there may be in the Defense Department. Possibly you may be doing it in your contracts with people where you know you are going to have to train new skills.

Mr. BANNERMAN. I would like to mention one relatively minor phase of it, Mr. Curtis. We do allow reasonable training programs of contractors as costs under our cost reimbursement and other cost price contracts.

Representative CURTIS. Of course, in the overemployment in the aircraft industry, I was very much interested where you pointed out that they went up really beyond what they really had work for and that cutback some, too. That looked like wasted skill and wasted training. I guess that would have to remain at the contractor level but, on the other hand, if you do put into your contract something of this nature as to training skills, you do have some control over it there, do you not, as to overemployment in some of these industries?

Mr. BANNERMAN. There are various ways of coming at overemployment by contract. One, of course, is to provide a contract with substantial risks and force the contractor to control it himself. Of course, we also seek under our cost type contract to assure that they are not billing to the Government unnecessary employees.

Representative CURTIS. That gets back to this question we were discussing elsewhere too, as to the subcontracting out. If the prime, of course, takes on a new division to do something when they really could have subcontracted it out, that seems to be a waste too, and something that would in the long run not be advantageous to the Government or to the producer, really.

Mr. HITCH. No, the prime can create an artificial bottleneck unless this is kept under scrutiny.

Representative CURTIS. Could you state briefly if you have any plans for changes in the timing of the payments to Defense contractors, and now I am talking about a specific problem.

Mr. HITCH. Yes, you know we have made a change as far as cost based contracts are concerned.

Representative CURTIS. Some of this was involved in these missile bases, I understand.

Am I right on that? It does not matter what it was specifically.

Mr. HITCH. I imagine so.

Mr. BANNERMAN. The problem of the missile base construction did not have to do with the timing of payments but it had to do with the difficulty in the contracting officer and contractor agreeing on the appropriate amount for many of these very extensive changes.

I will not say that that has been solved but the problem is much less immediate than it was.

Representative CURTIS. I know that changes were a big part of it but I also thought that there was this problem of the holdback on the contract itself.

Mr. BANNERMAN. I think that there may have been that on some of the missile contractors but the missile base construction contracts were all fixed-price contracts and they were not subject to the holdback applicable to cost type contracts.

Representative CURTIS. What is the current balance of working capital funds in the Defense Department and how much can you draw upon these to accelerate your Defense programs?

Mr. HITCH. That is a very complicated question, sir. I do not have the financial plan before me but the total obligations that we will have outstanding at the end of this fiscal year we estimate to be $25 billion.

Representative CURTIS. $25 billion?

Mr. HITCH. This is "unpaid obligations" at the end of fiscal year 1961.

Representative CURTIS. Of course, those are not all working capital funds, are they?

Mr. HITCH. Oh, no. I will provide for the record a summary of our transfers from the working capital funds.

(The material referred to follows:)

TRANSFERS FROM STOCK FUNDS AND INDUSTRIAL FUNDS

The 1962 budget, as revised, proposes the transfer of $470 million of cash from stock funds and industrial funds to general appropriation accounts, thereby reducing the amount of new obligating authority requested to finance the defense program in fiscal year 1962.

Transfers from these funds are proposed as follows:

[In millions]

	Proposed for transfer by initial budget	Additional proposed for transfer by budget revision	Total now proposed for transfer
Stock funds, total	$150	$180	$330
Army	125	115	240
Navy		35	35
Marine Corps		11	11
Air Force	25	19	44
Industrial funds, total		140	140
Army		100	100
Navy		20	20
Air Force		20	20
Grand total, transfers from working capital funds	150	320	470

Stock funds.—A cash policy for DOD stock funds which calls for retention of cash equivalent to about 60 days of the estimated budget year expenditure rate has been followed for the past 3 years.

The original fiscal year 1962 estimate provided for retention of $895 million or 66.4 days of expenditure—slightly higher than the 60-day rule. The transfer recommended was $150 million. A review of stock fund programs, however, indicated that these accounts could operate effectively with a lower cash balance, and additional transfers have been recommended in the amount of $180 million. The total recommended transfer is now $330 million. This reduces cash to a 52.9-day level.

In the years since the enactment of title IV of the National Security Act of 1947, under which stock funds operate, appropriations and transfers to stock funds have totaled $2.1 billion, while cash rescissions and transfers from stock funds through fiscal year 1962 will equal $5.6 billion—a net cash reduction of $3.5 billion. This excess cash has generated as the result of the sale of long suply inventories which did not require replacement.

Further extensions and expansion of stock funds are under study. Therefore, operating cash may be required in additional amounts in the future. Should operations in future years fail to generate needed cash capital, appropriations to stock funds will be required. Meanwhile, cash balances will be kept to the lowest levels consistent with effective stock fund management.

Industrial funds.—Since the industrial funds were established under title IV of the National Security Act of 1947, a total of $1,083,020,000 has been provided for cash capital, by the transfer, with congressional approval, of unexpended balances of other appropriations. Rescissions and transfers to date total $492 million. It is now proposed to transfer an additional $140 million in 1962, to bring the total transferred and returned to $632 million through 1962.

Industrial fund activities carry only working inventories, and perform work only on order of customers, and therefore, are not in a position to increase cash working capital through sale of long supply stocks, as in the case with stock funds. Unallocated working capital has been held in these funds to allow for extension of the industrial fund concept to other suitable installations.

Should it be determined that the industrial fund ought to be extended to other activities in the future, added working capital will be needed, and it may become necessary to request appropriations for this purpose.

Representative CURTIS. I was just trying to figure out how much financing the private companies are bearing in some of these and whether or not acceleration of those payments would not be a way of jacking this economy up right now; in other words, if those contracts are moving well and this money could be released.

Mr. HITCH. I see.

Representative CURTIS. It is related to the previous question.

Mr. HITCH. I see. There was one action that we took this spring that had that effect.

Beginning in 1957 the Defense Department adopted a policy of holding back 20 percent of cost based contracts until completion of the contract.

Representative CURTIS. That is what I was referring to.

Mr. HITCH. Which required these companies to finance 20 percent of the work from their own sources. We did rescind that order this spring.

Representative CURTIS. That is where the changes came in because they were being required to finance a good bit of the changes too and that imposed a greater burden than many of them had anticipated. In fact, I heard that some very large companies actually were going to be in a serious situation and were faced with a real fiscal problem.

Mr. HITCH. New contracts will no longer contain this clause. We can fully finance them as we go along and the old contracts which do contain the clause are being, in many cases, renegotiated.

Representative CURTIS. In other words, the renegotiation could be accelerated in this area, could it not? I do not know how much we are talking about. I do not know whether we are talking about as much as $100 million or not.

Mr. HITCH. An estimated $175 million is affected by this.

Representative CURTIS. Thank you.

Senator PROXMIRE (presiding). When my time ran out last time you were just saying, Mr. Hitch, that we know we want to stimulate the economy now. We do not know whether we are going to want to later. We may or may not and therefore the speedup is being engaged in now.

It seems to me that my reply to that, and if you want to make a further observation I would be happy to listen to it, is that it is true that we are in a period of recession but all the evidence that we seem to get before this committee suggests that we are likely to continue to be in a period of recession as far as employment is concerned for a long, long, time, and, in view of the fact that the Defense Department is making such a major contribution in these 3 months through obligations as compared with any other period before or after, it just seems to me that it might have been wiser not to engage in this degree of speedup at this time; but I see that you were perfectly correct in referring to what the President had said.

I want to make my position clear, too.

He said in his initial message on this which was on February 2:

I have directed the Cabinet and agency heads to submit by February 17 inventories—

et cetera—

any additional construction or other projects which could be initiated at an early date.

Then he specifically singled out roads, recreational facilities, and forests and the project work inventories of the Forest Service.

This is all he said and it seemed to me that, by omission, he might have been omitting the Defense Department in view of the fact that this stemmed from Paul Samuelson's statement which I know is not the statement of the President of the United States which nevertheless said this:

Defense expenditures ought to be determined on their own merits. They are not to be the football of economic stabilization. Nor, as was so often done in the past, ought they to be kept below the optimal level needed for security because of the mistaken notion that the economy is unable to bear any extra burdens.

He goes on to indicate that defense in the judgment of Mr. Samuelson should be excluded from this and, as I say, the President, by omitting defense from the specific areas where he thought a speedup could be most useful, seemed to imply that your Department at least should not be primarily concerned with this.

Mr. HITCH. Well, we did contribute less than our quota in a sense. We account for half the total expenditure and we contributed only a quarter of the acceleration.

I would agree in general with Professor Samuelson's statement but I think that there are some accelerations of the type that I mentioned that we can engage in and at the margin we can take other things into account.

Senator PROXMIRE. Mr. Curtis just added another element because you just apparently in the last few weeks rescinded your 20-percent withholding payment and your renegotiating has another big impact in this quarter so that, when you analyze the impact of the Defense Department in the months of April, May, and June on our economy it seems to me it is to be tremendous as compared to anything before or which is to follow.

Mr. HITCH. You perhaps do not think that it will but, if the occasion ever demands, it seems to me that the same sort of things could be done in reverse.

Senator PROXMIRE. Well, in part perhaps, but once again I agree with Mr. Samuelson that it should not be made the football of economic stabilization and there is a seasonal factor here, is there not? This is the quarter where most of the impact has been traditionally.

Mr. HITCH. Yes, there is a seasonal pattern in the letting of these contracts.

Senator PROXMIRE. Plus the fact that 1961 is the big year. At least it seems to be at the present time.

Mr. HITCH. Yes.

Mr. PROXMIRE. Now, in your statement you say:

there are certain activities such as the procurement of common items of supply, and the repair, rehabilitation and modernization of the existing plant, which can be scheduled so as to assist in meeting the exigencies of the present economic situation.

Are you not referring to such items as expanding the inventory for 11,000 dozen oyster forks to which you refer on page 51 of your book?

Mr. HITCH. I think that reference to oyster forks comes from Senator Douglas. I think they are a matter of record.

Senator PROXMIRE. They also came from your book.

Mr. HITCH. Yes. Of course, on either accelerated or nonaccelerated procurement it is quite possible to buy the wrong or useless things.

Senator PROXMIRE. You see, I do not want to belabor this point too much but I am trying to investigate whether it is not true that if the Defense Department is not buying at the right time there is something wrong with the purchasing end of the Defense Department, that either they are putting in stock inventory that is not needed at the present time or they are engaging in repair and rehabilitation before the time is ready or it seems to me that they are simply correcting a situation which was an error in the past.

Mr. HITCH. Well, we do have reserves that we want to build up to certain levels for certain kinds of emergencies.

The speed with which we reach these targets is something that we can adjust. We can reach them this year or next year or 5 years from now.

Senator PROXMIRE. Now, I want to get back to this statement of yours about nonproduction workers having grown steadily. Perhaps you have answered my question by saying that you think this primarily indicates the technological change in the production.

Mr. HITCH. I think it is primarily that, yes, sir.

Senator PROXMIRE. Might it not also reflect the fact that their contracts are negotiated on a cost-plus basis and there is not so much incentive for the contractor to make economies under these circumstances?

Rosy the Riveter may have left the assembly line but she has gone into the boss' office to join the public relations or legislative liaison or lobbying end of the business.

Mr. HITCH. It could be. I am not sure. I do not think that this is an important factor because we also had negotiated contracts in 1956 and 1957. There has been no change, I think, in the contracting policies between these two dates.

Senator PROXMIRE. We had negotiated contracts. Is it not true that the proportion of contracts which are competitive has diminished and diminished pretty sharply over the past 10 years?

Mr. HITCH. I doubt if that is true in aircraft and missiles.

Senator PROXMIRE. Overall for defense.

Mr. BANNERMAN. The only figures that we have that go back that far, Senator, relate to the ratio of our contracts awarded.

Senator PROXMIRE. Yes.

Mr. BANNERMAN. The ratio in that respect has not changed substantially in 12 years.

Senator PROXMIRE. Can you give me specific percentages?

Mr. BANNERMAN. Yes, sir. This is by dollars. The ratio of our advertised contracting to total contracting in fiscal year 1951 was 12.1 percent; 1952, 10.8; 1953, 11.1; 1954, 15.6; 1955, 16.0; 1956, 15.9; 1957, 17.4; 1958, 14.3; 1959, 13.6; and 1960, 14.0.

So that, while there have been a few year by year changes depending on changes in the mix of what we are buying primarily, there has been no trend over those years.

(Additional materials on this point supplied for the record follow:)

Number of procurement actions (except intragovernmental)

Fiscal year	Total number of all actions	Small purchase transactions (open market purchases) [1]	Remaining actions (formal procurement actions over $2,500)		
			Total	Formally advertised	
				Number	Percent of total
1951	2,570,342	[2] 2,043,422	526,920	179,124	34.0
1952	3,046,976	[2] 2,422,346	624,630	189,181	30.3
1953	2,798,904	[2] 2,225,129	573,775	210,240	36.6
1954	2,940,799	[2] 2,337,935	602,864	203,600	33.8
1955	3,585,897	[2] 2,850,788	735,109	251,934	34.3
1956	3,977,159	[2] 3,161,841	815,318	301,496	37.0
1957	4,326,895	3,328,414	998,481	315,866	31.6
1958	4,458,195	3,658,668	799,527	275,041	34.4
1959	[3] 5,851,467	4,830,313	1,021,154	283,220	27.7
1960	6,106,234	5,040,654	1,065,580	273,256	25.6

[1] Secs. 2304 (a)(3) of U.S.C. 10 authorizes negotiation of all procurement actions with a value of $2,500 or less. For the period January 1951 through December 1955, however, all negotiated procurement actions were negotiated under sec. 2(c)(1), national emergency. The number of small actions for fiscal year 1951 through 1956 have, therefore, been estimated on the basis of the fiscal years 1957 and 1958 experience.
[2] Estimated.
[3] In fiscal year 1959 the Navy Department included for the 1st time procurement actions of small activities with purchasing authority up to $1,000 per action. This resulted in a sharp increase in the number of procurement transactions reported.

Mr. HITCH. Nevertheless, Senator, the fact that these are negotiated contracts means that the proportion of nonproduction workers might be too high but it does not account for the fact that the proportion has risen. I think we have to look elsewhere for that.

Senator PROXMIRE. Unless it may mean that these firms are doing a larger and larger portion of this work with the Federal Government and, as in the case of one firm I know of in my State, as it does more than 95 or 99 percent of its work with the Federal Government, as it is overwhelmingly on noncompetitive bids, it seems to me that the discipline which you refer to in your book, which you have in the present system for keeping your cost down begins to disappear. The pressure which is much stronger in the overhead bureaucracy of a corporation than it is on an assembly line for building it up is likely to become bigger.

Mr. HITCH. Again I think in this respect, too, there has been no significant change over this period.

The aircraft industry was also a number of years ago working primarily for the Defense Department.

Senator PROXMIRE. You have seen no change. My time, I believe, is precisely up. I will pass to Mrs. Griffiths.

Representative GRIFFITHS. Many of the productive workers since 1956 have been laid off, is that not true, or have they actually hired additional productive workers in the aircraft industry? Your statement is on a percentage basis.

Mr. HITCH. They have been laid off.

Representative GRIFFITHS. They have been laid off.

The question is, did they lay off the nonproductive workers or not?

Mr. HITCH. I would have to do some calculating. My impression is that they both declined.

Representative GRIFFITHS. Except that the nonproductive workers did not decline nearly as rapidly as the productive workers.

Mr. HITCH. Yes.

Representative GRIFFITHS. I would like to ask a question on this matter of payments. You have contracts, do you not, where you set aside a certain portion of the prime contract that is to be bid upon by small business subcontracting? A certain percentage of subcontracting is to be given to small business. Is that right or not?

Mr. BANNERMAN. I do not know of any contract where we have set aside a specific percentage for bidding by small business. We did have a contract that was awarded recently where we set a percentage as to the amount that must be subcontracted.

Representative GRIFFITHS. A percentage.

Mr. BANNERMAN. But that is relatively rare in our practice.

Representative GRIFFITHS. When a subcontractor has delivered the product to the prime, does the prime pay the sub or does the Government pay the sub?

Mr. BANNERMAN. The prime pays the sub.

Representative GRIFFITHS. The prime pays the sub.

Do you have any method of checking on when they pay the sub?

Mr. BANNERMAN. Not across the board, Mrs. Griffiths. We have a provision in our regulations that goes into our prime contract which authorizes progress payments to subs just as we make to primes and we do, of course, police those because we reimburse the prime for 100 percent of those progress payments.

Representative GRIFFITHS. I had a complaint in my district recently from a sub where the prime had not paid for 6 months and it had put the sub out of the subcontracting business. The prime took over the job he was doing.

Now, the original contract requirement had been that the prime subcontract, and he brought up this matter. If there is any way in which you can expedite these payments it seems to me that it would be desirable. It is most unfair for them to ask the subs to permit them to use their money which is really what they are doing.

Mr. BANNERMAN. We have, of course, also received complaints of this nature from time to time and when we do we try to adjust them. I think it is pretty clear that we cannot normally on an across-the-board basis police the business relations between primes and subs. It would be a far greater volume than we could handle.

Representative GRIFFITHS. Thank you very much.

Senator PROXMIRE. Mr. Pell.

Senator PELL. I have no questions.

Senator PROXMIRE. Mr. Curtis?

Representative CURTIS. I have just one comment. I think the figures are that there has been a shift in all manufacturing in recent years from the blue collar to white collar.

Mr. HITCH. That is right.

Representative CURTIS. I do not know whether this has been greater. I think the point is well taken and needs to be looked into. I have the figures here for 1953, production and miantenance jobs, 13.8; to nonproduction, 3.4; in terms of thousands; and in 1960, 12.2 in production and maintenance jobs; so that there has been an absolute decline. In nonproduction jobs for 1960 4.07 so that there has actually been an increase.

The shift has been considerable but I think the point still could be very valid. There seems to be a trend in all manufacturing.

That is all.

Senator PROXMIRE. You say:

> But even when we isolate employment on Navy work, there is a marked lack of correlation between the increase in defense expenditures on shipbuilding and employment in all shipyards on Navy work. Although expenditures have doubled from fiscal year 1957 to fiscal year 1960, average employment on Navy work in 1960 was only a few thousand more than 1957.

Then you go on to say:

> The major reason for this apparent discrepancy is the rapidly increasing proportion of the defense shipbuilding dollar going for work done outside the shipyard—particularly for electronics, armaments, and powerplants.

If this is the major reason, it seems to me that there is such an enormously drastic and sharp shift where you have a doubling of expenditures in almost the same employment, I wonder if there has been any study to corroborate this speculation because it would seem to me that once again you have the same kind of problem that you are confronted with in this defense industry which is likely to engage in some practices that are not efficient because you do not have the same discipline.

Mr. HITCH. I would be very happy to look into this and give you a considered judgment on the depth of the study that resulted in this statement.

(The matter referred to follows:)

CORRELATION BETWEEN DEFENSE EXPENDITURES FOR SHIPS AND SHIPYARD EMPLOYMENT

There are several reasons for the apparent lack of correlation in recent years between defense expenditures for ships and employment on Navy shipbuilding.

First, it should be noted that while the increase in employment on new construction of Navy ships has not paralleled the rise in expenditures from the Navy's shipbuilding and conversion appropriation, it has nevertheless increased significantly. In fiscal year 1958, the post-Korean war low point, monthly employment averaged about 60,350. In the first half of fiscal year 1961, this had risen to a monthly average of 87,200, or a gain of nearly 45 percent.

Second, part of the rise in expenditures without a corresponding rise in employment is due to the fact that there has been a fairly steady rise in naval shipbuilding prices and wages. The Navy's composite "cost of shipbuilding" index has risen from a monthly average of 141.1 in fiscal year 1958 to 154.2 in the first half of the current fiscal year. This represents an increase of 9 percent in less than 3 years.

By far, however, the most important reason for the failure of shipyard employment on new ship construction to follow Navy expenditures for this purpose is the technological revolution in weapon systems. Although not as dramatic a change, perhaps, as in aircraft and missile manufacturing, the Navy's shipbuilding program has undergone marked changes in recent years. With the advent of advanced electronics and communications systems, nuclear power, and guided missile armament, a larger and larger part of the "shipbuilding dollar" has gone not to the yards for shipwork and shipwork employment, but to the specialized industries outside the yards which produce the costly installed systems for modern combat vessels.

For example, expenditures from the "Shipbuilding and conversion, Navy" appropriation to pay for ordnance equipment installed on ships has increased over 3½ times from 1957 to 1961—from $106 million to $380 million. Although detailed statistics are not available for electronics expenditures on the same basis, the evidence indicates that there has been a similar rise in this area, too.

More specifically, only about 25 percent of the cost of a destroyer as recently as the fiscal year 1956 program was for armament and for electronics. A modern guided missile destroyer in the fiscal year 1961 program has about 41 percent of its cost for armament and electronics items, and a modern frigate (DLG) about 45 percent.

Similarly, a conventionally powered submarine laid down in 1956 represented about 90 percent shipwork and 10 percent for armament, electronics, and powerplant. The corresponding figures for a modern nuclear-powered attack submarine are only 67 percent for shipwork and 33 percent for the other items. Even more extreme is the case of Polaris submarines which have become so large an element in the shipbuilding program in the last few years. In the case of a Polaris submarine only 51 percent of the programed cost is for work in shipyards, and 49 percent goes for armament, for electronics, and for the nuclear propulsion system.

The overall effect of these trends can be measured in terms of the percentage of each year's shipbuilding program value which went to shipyards. In the 1953–55 period, this averaged about 75 percent. With the exception of 1960, all recent years have been under 60 percent and in both 1958 and 1959 it was barely 50 percent.

Furthermore, even the low percentages of SCN program dollars earmarked for the shipyards in recent years may tend to overstate the effect on actual shipyard employment. Navy policy in the last few years has been to consolidate as much of the shipwork as practical into the contracts awarded to the shipyards. The yards would be expected to handle the subcontracting necessary for work on items not producible in the shipyards. As a result of the consolidation policy, there probably has been a tendency for a greater part of the shipyard's own portion of the program (as given in the above statistics) to "leak away" in the form of increased subcontracting.

In the light of these trends, the rise in expenditures for ships, without a proportionate increase in employment, can be viewed as a result of the same technological revolution in weapons which has so significantly affected other defense-related industries.

Senator PROXMIRE. Very good, because that certainly is a striking situation. We would know nothing about it, of course, if you had not brought it to our attention.

On page 21 when you discuss the balance of payments, you say that:

> The previously planned actions to save $65 million by procuring equipment and supplies in the United States at a cost differential of no more than 25 percent will be continued, as will the actions to save $25 million in the military assistance program.

What is the additional cost to the taxpayer involved in conserving our gold and trying to even up our balance of payments as far as all of the Defense Department's activities are concerned?

I just quickly calculated the $65 million might go as high as $13 million in additional cost.

Mr. HITCH. At a maximum. It is actually less because it is "up to" 25 percent. However, it does increase quite rapidly as you go beyond 25 percent.

If we extended this particular method, this particular program, of bringing procurement back to this country even where the cost differential was higher than 25 percent, the percentages do go up very rapidly and the cost to the taxpayer would be increased markedly.

Senator PROXMIRE. Are you making any study to determine whether or not other countries are reacting adversely to this; in other words, setting up contrary programs and not responding as President Kennedy hoped they would, and has said many times they should, in knocking out their obstacles to our exports which are their imports?

Mr. HITCH. I am not aware of any adverse reactions to this particular program. None has been brought to my attention. We do certainly feel that there are other things that certain of our allies could do that they have not been doing that we are still trying hard in negotiating with them to get them to do.

Senator PROXMIRE. You do not feel that their attitude is that this is our own procurement and if we want to procure it within our own country and not patronize them, it is our business. You feel that that is more likely to be the reaction rather than saying, "If you are going to patronize your country and not ours, we will do likewise"?

Mr. HITCH. No; nothing has come to our attention yet. If we were to follow this policy further and procure in this country even though it were to cost 100 percent more, I assume we would get some sour reactions.

Senator PROXMIRE. I wonder if you could make available your calculations in terms of chapter 7 of your book why, in terms of budget input on the one hand and defense kill and target destruction on the other, it might be better for the defense dollar to be spent for, say, modernizing the Army and additional airlift and so forth as compared with buying one additional aircraft carrier? I ask that because we had a debate on this specific question in the Senate last time, and I had a great problem in my position where I was against the aircraft carrier and was trying to get some objective criteria which could have any real weight because, you see, the Armed Services Committee comes in with their recommendation and it might contradict what the House has done and might contradict what seems to be the best judgment, and a Senator is in a position of trying to dispute this but he is the victim of what may be mistaken judgment of his colleagues.

I am wondering if this method, which appeals to me very, very much, is not necessarily deciding where the money should go, but at least giving you some objective guidance, some criteria which you could use for an assessment which could be useful in that kind of problem.

Mr. HITCH. Senator, I would be very happy to give you examples of the criteria that can be used in a calculation of this kind.

The difficulty about the actual calculations is that many of the inputs of them are necessarily and properly classified. They include our intelligence estimates and so forth. These are essential imports. These are not calculations that in their entirety can be made available for presentation on the floor of the Senate, for example.

Senator PROXMIRE. That is an excellent objection, but as a Member of the Congress I want to tell you that it would be mighty useful if you or somebody on your staff would attempt to put together some objective criteria so that, when this enormous budget comes up, we would have some basis of determining whether amendments to it are wise or unwise other than our own instinct or the inadequate information we can get.

Mr. HITCH. I hope we can get more of this kind of calculation into the preparation and support of the budget.

Senator PROXMIRE. There is a tendency for this to be in support of the administration's position.

Mr. HITCH. Yes, sir.

Senator PROXMIRE. I am wondering if those of us who may disagree from time to time about the administration's position would be able to have this kind of a criterion and experts available to work it out so that we might be able to arrive at a logical position and contradict what the administration is asking.

Mr. HITCH. As far as the method is concerned, of course, I have discussed it in various parts of the book at considerable length and the last chapter is an example.

Senator PROXMIRE. The appendix?

Mr. HITCH. Not the appendix.

Senator PROXMIRE. That was too complicated for me.

Mr. HITCH. Not the appendix, the last chapter.

Senator PROXMIRE. On page 230, you say, "Only a rather minor portion of service purchases are made, or can be made on the basis of competitive bidding."

Then you go on to give an example of 18 pages of specifications for pingpong balls and other horrible examples of bureaucratic requirements that make it impossible for us to have any kind of competitive bid.

In your judgment, could we not greatly expand the advertised competitive bidding somehow, because it seems to me that here is one way in which the taxpayer can really save a lot of money, and you can eliminate many of the abuses which you are bound to have in negotiation, with the best of will and greatest of patriotism on the part of all involved?

Mr. HITCH. I wish I could say "Yes," because it does seem to be a fairly easy and satisfactory way out despite our doubts about some of the competitive bidding; but the trouble is that most of this procurement is for the major hard goods. They are for the new missiles. They are for these recently developed or currently being developed equipments where you just cannot lay down specifications in advance.

Senator PROXMIRE. That is the standard, traditional answer all right. We are all familiar with it. I am just wondering if you cannot either break the big weapon system procurement down for prime contracts or require your prime contractors when they solicit subcontracts to solicit competitive bids on a more widespread scale than they do.

Mr. HITCH. Do you have any comments?

Mr. BANNERMAN. Yes; I would like to say, in supplement, Mr. Hitch, to what you said a moment ago, that if you simply add together the dollars which we have, say, in fiscal 1960 in research and development contracts as such plus major weapons where you may have as much as a $50- to $100-million investment in a particular company which it is simply not practical to take anywhere else, you have right there come to about 10 or 15 percent of the total dollars that we currently negotiate.

Senator PROXMIRE. Where you have a $100-million contract with one company, cannot you proceed and insist?

Mr. BANNERMAN. We agree; and we think that there is a great deal more that can be done with respect to our major prime contractors' or subcontracting programs, and we are currently requiring them to place bids competitively wherever this is possible to do.

I think that our effort probably in that field in the next year should be to greatly improve our administration and our prime contractors' administration of that program.

Senator PROXMIRE. I certainly hope so because it seems to me that this is an area where we can save a great deal of money. I know that you are trying. If you could indicate from time to time to the Congress precisely what you are doing, it would be mighty helpful because we all want to save money and this is the big fat item in the budget where savings can be very big.

Mrs. Griffiths?

Representative GRIFFITHS. No; thank you.

I certainly enjoyed it.

Senator PROXMIRE. Mr. Pell?

Senator PELL. I have no questions.

Senator PROXMIRE. Mr. Curtis?

Representative CURTIS. I would certainly add to what Senator Proxmire said. I am satisfied that a great deal can be done in this area. So much of this is common use, even in your so-called secret weapons and missiles. You break it down into component parts and a lot of those parts are pretty common items. Not that an effort has not been made, but if a concentrated effort were made in this area, I am satisfied we could save considerable amounts of money and end up with much, much better procedures and probably end up with better military weapons.

I have never been able to document this thing, and maybe it cannot be done, but Admiral Rickover once said to me that a very substantial part of the first Polaris submarine was handled through advertised bids in this breaking down into components and passing it out, and they were way below their estimates, as I understand, on cost items. Incidentally, they hit their target date of completion and improved upon it.

Certainly, if we can do it with a secret weapon like that, and nothing could be more in the advanced area of innovation, it could be done in the other areas.

The other comment I would like to make is to emphasize again the garbage-pail technique of the old mess sergeant to find out what is wrong in procurement practices for the mess by looking and seeing what is in the garbage pail and wondering how it got there. You may take a look at these surplus lists of properties which are around $26 billion that we have available, and, if you go down those lists, some of it is military weapons but so much of it is commonly used items—beds, furniture, paper, typewriters, and so on. We should look at those and go backward and find out how they got there, what sort of procurement practice produced that. We are always going to have some waste, in my judgment, but of course, it is a question of where we can cut down on a lot of it.

I certainly feel, as Senator Proxmire has said, that this is an area where it seems that reason dictates that we could make vast improvements.

Senator PROXMIRE. I would like to ask just a few more questions.

I want to apologize to the committee and to you gentlemen for taking so much time.

President Kennedy as a Senator was extremely interested in consolidating purchasing in the Armed Forces. In fact, the Hoover Commission recommendation which he offered several times passed the Senate. It might have passed the House in different form, but never became law. We have heard very little of that, but it is certainly attractive to those of us who know very little about the Defense Department. It is an obvious way in which money can be saved by consolidating purchases for the competitive services, especially when we see these gigantic inventories and see where one branch disposes of an article and it is bought by another branch at a higher price from a speculator.

Is there any consideration being given to this Hoover Commission recommendation?

Mr. HITCH. A great deal of action has been taken in that direction in the last few years and some is underway right now—establishing single managers for items throughout the services.

Mr. BANNERMAN. The vast preponderance of the common items that the Department buys—and by common items I mean items used by more than one department—are under a single management right now for all purposes.

Senator PROXMIRE. Do you feel that additional legislation would be useful on this subject?

Mr. HITCH. I personally do not.

Senator PROXMIRE. Do you feel that the Hoover Commission recommendations have been pretty well met already by executive action?

Mr. BANNERMAN. I think there is no lack of authority to do anything that is need in this field.

Senator PROXMIRE. That is a diplomatic answer.

On page 313 you say:

> We must contemplate disaster and plan to prevent it or, if it occurs, to preserve a basis for recuperation.

Then you go on on page 324 with what I think is a most remarkable statement. You say:

> Worst of all, this policy could appear to be provocative and thereby reduce our deterrence of all-out war. The enemy could interpret preparations of this sort as steps toward a strike-first posture that would leave us vulnerable for several hours whenever brought into play. Instead of deterring the enemy, this policy might make a pre-emptive attack by him more likely. What conclusions would we draw if the Russians initiated a really large-scale effort in the construction of deep shelters?

Mr. HITCH. I am not talking about fallout shelters there. I am talking about deep shelters.

Senator PROXMIRE. Good. That brings me to the last question.

You know the prominence of the people who made the Gaither Report, Admiral Carney, General Doolittle and others who unanimously recommended a program of $5 billion a year for fallout shelters. It was never finished in full but the report made by Mr. Roberts of the Washington Post has been considered to be a true report of it.

In addition the Rockefeller Committee and the people who were on this included Gordon Dean, Roswell Gilpatrick, Henry R. Luce, General McCormack, Edward Teller, also recommended fallout shelters as a very important method of protecting this Nation.

The main burden of my questioning has been related to trying to tie in our defense problem with having many unemployed and having vacant or idle factory capacity. Consequently I would like to know why has there been no apparent consideration of this problem? At least the President has neither dismissed it nor recommended it nor indicated that he is studying it in this budget.

Mr. HITCH. Well, sir, I cannot answer that question.

Senator PROXMIRE. You do not feel that this would be provocative?

Mr. HITCH. Fallout shelters? No, I do not feel that fallout shelters would be provocative. The responsibility for the sheltering of the civilian population is not a Defense Department responsibility. It is an OCDM responsibility.

Senator PROXMIRE. Do you mean to say that, in spite of these recommendations which fall into the internal national security and military aspect category, this would be left up to the Office of Civil Defense?

Mr. HITCH. Yes, it is. That is the way our executive branch is organized. I have some personal views about it and many other people in the Defense Department do, but it is not a responsibility of the Department of Defense.

Senator PROXMIRE. What are your views?

Mr. HITCH. I am not sure that this is the right place. I have expounded my views, I think, in my book. I am not sure that they have changed since then.

Senator PROXMIRE. Your views are expressed in the book. How do you square the administration's decision to concentrate space and missile research in the Air Force with your thesis that research on vastly important problems should be deliberately duplicated? You give some excellent examples of how duplication of research has helped us, having different teams of people compete.

Mr. HITCH. I think it is very important in a new field of technology—if it is an important field of technology—to have more than one customer or organization responsible for supporting research.

We do have in space at least two. We have the Air Force and we have NASA both supporting broad programs of space research.

In addition we still have the other services who are supporting a certain amount of basic fundamental research.

Senator PROXMIRE. Missile?

Mr. HITCH. As well as in space, related things like missiles. I did not argue in my book for an unlimited amount of duplication even in the field of basic research and certainly, when you get to the development of systems, you want much less and I am not sure that we have too little, even after the issuance of this order.

Senator PROXMIRE. You were asked by Congressman Curtis about the working capital position of the Defense Department. Do you have idle balances on demand deposit with the banks?

Mr. HITCH. I was speaking of something else. I was talking about our obligational authority from Congress in the past which we had not yet obligated by the end of this fiscal year.

Senator PROXMIRE. I am talking about this. I have read and heard criticism that the agencies have an enormous amount of money on deposit at banks; that, instead of putting these funds into obligations that might bear interest to the Government, they are sitting idly in banks and the banks in turn are able to take those funds and invest them and get a big profit out of them; and since the Defense Department is by far the biggest department of Government. I am wondering if you can tell us whether or not the Defense Department has been following this policy?

Mr. HITCH. This is something that I have no information on.

Senator PROXMIRE. Would it not be proper for me to ask this question and for you to give me an answer if you can discover this?

Mr. HITCH. I would be glad to attempt to answer it.

Senator PROXMIRE. We found in our own State government that this was the case and a great deal was saved. It is a natural thing for departments, especially one like yours that has to make enormous payment, to do but on the other hand careful management of those funds to work them as hard as possible can save the taxpayers a great deal of money.

Mr. HITCH. I will see what is available on this. It is just an area that I have not yet explored.

(The information follows:)

In the continental United States, the Department of Defense generally does not have any public funds deposited to its credit with commercial banks. All collections are deposited in banks under the Federal Reserve System to the Credit of the Treasury and all checks are written directly against the Treasury. In oversea areas there are some public funds in commercial banks to the credit of individual disbursing officers of the military departments. These banks are specifically designated by the Treasury Department, and such arrangement is necessary since the Federal Reserve System does not extend overseas. As a matter of policy, the military departments do not maintain balances in these banks in excess of their current operating needs.

Senator PROXMIRE. This concludes the committee's hearings on the economic report, the report of the economic situation and the outlook.

The hearings have been most helpful to the Congress and to the general public.

We owe a vote of thanks to all the witnesses who have testified for the preparation of their statements, giving their valuable time, and we want to thank you, Mr. Hitch and your assistants, for your appearance. It was very informative and very helpful.

The committee stands adjourned.

(Whereupon, at 4:30 p.m., the committee adjourned, subject to the call of the Chair.)

APPENDIX

[From Press Office of President-elect John F. Kennedy, New York, N.Y., Jan. 6, 1961]

(Following is a report on the state of the American economy prepared by Dr. Paul A. Samuelson, professor of economics at MIT, who headed a special task force for the President-elect on economic conditions in the United States:)

PROSPECTS AND POLICIES FOR THE 1961 AMERICAN ECONOMY

A Report to President-elect Kennedy by Paul A. Samuelson

I. THE ECONOMIC OUTLOOK

1. *Recession.*—Economic experts are generally agreed that the Nation's economy is now in a "recession." The slide since mid-1960 cannot be termed a "depression" like that after 1929, but so widespread a decline in production deserves more than the euphemism of a "rolling readjustment."

Prudent economic policy must face the fact that we go into 1961 with business still moving downward. This means that unemployment, now above 6 percent of the labor force, may this winter rise more than seasonally. It means still lower profits ahead.

The fact of recession also has significant implications for the prospective budget. It means a falling off of tax receipts from earlier estimated levels. This recession is wiping out the previously estimated budget surplus for the fiscal year ending June 30. Many experts now believe that as of today it is reasonable to forecast a deficit for this fiscal year, assuming only expenditures already authorized and in the absence of desirable new expenditures from an accelerated effort. Recalling the experience of the 1957–58 recession may be useful: Due large to the impact of a recession that everyone but the authorities admitted was then taking place, the announcement in early 1958 of a small fiscal 1959 budget surplus was actually followed by a final fiscal 1959 budget deficit of more than $12 billion. Not even the ostrich can avert the economic facts of life. He misreads the role of confidence in economic life who thinks that denying the obvious will cure the ailments of a modern economy.

No one can know exactly when this fourth postwar recession will come to an end. A careful canvass of expert opinion and analysis of the economic forces making for further contraction suggest this probability.

With proper actions by the Government, the contraction in business can be brought to a halt within 1961 itself and converted into an upturn. Recognizing that many analysts hope the upturn may come by the middle of the year but recalling how subject to error were their rosy forecasts for 1960, policymakers realize the necessity for preparing to take actions that might be needed if this fourth recession turns out to be a more serious one than its predecessors.

2. *Chronic slackness.*—In economics, the striking event drives out attention from the less dramatic but truly more fundamental processes. More fraught with significance for public policy than the recession itself is the vital fact that it has been superimposed upon an economy which, in the last few years, has been sluggish and tired. Thus, anyone who thought in 1958 that all was well with the American economy just because the recession of that year bottomed out early was proved to be wrong by the sad fact that our last recovery was an anemic one: 1959 and 1960 have been grievously disappointing years, as the period of expansion proved both to be shorter than earlier postwar recoveries and to have been abortive in the sense of never carrying us back anywhere near to high-employment and high-capacity levels of operation. This is illustrated by the striking fact that unemployment has remained above 5 percent of the labor force, a most disappointing performance in comparison with earlier postwar recoveries and desirable social goals.

If what we now faced were only the case of a short recession that was imposed on an economy showing healthy growth and desirable high employment patterns, then governmental policies would have to be vastly different from those called for by the present outlook. But this is not 1949, nor 1954.

Prudent policy now requires that we also combat the basic sluggishness which underlies the more dramatic recession. In some ways a recession imposed on top of a disappointingly slack economy simplifies prudent decisionmaking. Thus, certain expenditure programs that are worthwhile for their own sake, but that inevitably involve a lag of some months before they can get going, can be pushed more vigorously in the current situation because of the knowledge that the extra stimulus they later bring is unlikely to impinge upon a recovery that has already led us back to full employment.

The following recommendations try to take careful account of the fact that the recession slide is only the most dramatic manifestation of the grave economic challenge confronting our economic system.

II. FEASIBLE ECONOMIC GOALS

3. *Our economic potential.*—Had our economy progressed since 1956—not at the dramatic sprint of the Western European and Japanese economies or at the rush of the controlled totalitarian systems but simply at the modest pace made possible by our labor force and productivity trends—we could have expected 1961 to bring a gross national product some 10 percent above the $500 billion level we are now experiencing. With unemployment below 4 percent, with overcapacity put to work, and with productivity unleashed by economic opportunity, such a level of activity would mean higher private consumption, higher corporate profits, higher capital formation for the future, and higher resources for much-needed public programs. Instead of our having now to debate about the size of the budget deficit to be associated with a recession, such an outcome would have produced tax revenues under our present tax structure sufficient to lead to a surplus of around $10 billion; and the authorities might be facing the not unpleasant task of deciding how to deal with such a surplus.

4. *The targets ahead.*—Looking forward, one cannot realistically expect to undo in 1961 the inadequacies of several years. It is not realistic to aim for the restoration of high employment within a single calendar year. The goal for 1961 must be (1) to bring the recession to an end, (2) to reinstate a condition of expansion and recovery, and (3) to adopt measures likely to make that expansion one that will not after a year or two peter out at levels of activity far below our true potential.

Indeed policy for 1961 should be directed against the background of the whole decade ahead. Specifically, if the American economy is to show healthy growth during this period and to average out at satisfactory levels of employment, we must learn not to be misled by statements that this or that is now at an all-time peak; in an economy like ours, with more than a million people coming into the labor force each year and with continuing technological change, the most shocking frittering away of our economic opportunities is fully compatible with statistical reports that employment and national product are "setting new records every year."

5. *Prudent budget goals.*—A healthy decade of the 1960's will not call for a budget that is exactly balanced in every fiscal year. For the period as a whole, if the forces making for expansion are strong and vigorous, there should be many years of budgetary surpluses and these may well have to exceed the deficits of other years. Economic forecasting of the far future is too difficult to make possible any positive statements concerning the desirable decade average of such surpluses and deficits. But careful students of sound economic fiscal policy will perhaps agree on the following:

(i) The first years of such a decade, characterized as they are by stubborn unemployment and excess capacity and following on a period of disappointing slackness, are the more appropriate periods for programs of economic stimulation by well-thought-out fiscal policy.

(ii) The unplanned deficits that result from recession-induced declines in tax receipts levied on corporate profits and individual incomes and also those that come from a carefully designed antirecession program must be sharply distinguished from deficits that take place in times of zooming demand inflation. This last kind of deficit would represent Government spending out of control and be indeed deserving of grave concern. The deficits that come automatically from recession or which are a necessary part of a determined effort to restore the economic system to health are quite different phenomena: they are signs that our automatic built-in stabilizers are working, and that we no longer will run the risk of going into one of the great depressions that characterized our economic history before the war.

III. THE CONSTRAINTS WITHIN WHICH POLICY MUST WORK

6. *Gold and the international payments.*—Granted that the new administration is preparing a whole series of measures to correct our balance-of-payments position, the days are gone when America could shape her domestic stabilization policies taking no thought for their international repercussions. The fact that we have been losing gold for many years will, without question, have to affect our choice among activist policies to restore production and employment. The art of statecraft for the new administration will be to innovate, within this recognized constraint, new programs that promote healthy recovery.

It would be unthinkable for a present-day American Government to deliberately countenance high unemployment as a mechanism for adjusting to the balance-of-payments deficit. Such a policy would be largely ineffective anyway; but even were it highly effective, only a cynic would counsel its acceptance. It is equally unthinkable that a responsible administration can give up its militant efforts toward domestic recovery because of the limitations imposed on it by the international situation. What is needed is realistic taking into account of the international aspects of vigorous domestic policy.

7. *The problem of inflation.*—Various experts here and abroad, believe that the immediate postwar inflationary climate has now been converted into an epoch of price stability. One hopes this cheerful diagnosis is correct. However, a careful survey of the behavior of prices and costs shows that our recent stability in the wholesale price index has come in a period of admittedly high unemployment and slackness in our economy. For this reason it is premature to believe that the restoration of high employment will no longer involve problems concerning the stability of prices.

Postwar experience, here and abroad, suggests that a mixed economy like ours may tend to generate an upward creep of prices before it arrives at high employment. Such a price creep, which has to be distinguished from the ancient inflations brought about by the upward pull on prices and wages that comes from excessive dollars of demand spending, has been given many names: "cost-push" inflation, "sellers" (rather than demanders) inflation, "market power" inflation—these are all variants of the same stubborn phenomenon.

Economists are not yet agreed how serious this new malady of inflation really is. Many feel that new institutional programs, other than conventional fiscal and monetary policies, must be devised to meet this new challenge. But whatever be the merits of the varying views on this subject, it should be manifest that the goal of high employment and effective real growth cannot be abandoned because of the problematical fear that reattaining of prosperity in America may bring with it some difficulties; if recovery means a reopening of the cost-push problem, then we have no choice but to move closer to the day when that problem has to be successfully grappled with. Economic statesmanship does involve difficult compromises, but not capitulation to any one of the pluralistic goals of modern society.

Running a deliberately slack economy in order to put off the day when such doubts about inflation can be tested is not a policy open to a reponsible democratic government in this decade of perilous world crisis. A policy of inaction can be as truly a policy of living dangerously as one of overaction. Far from averting deterioration of our international position, a program that tolerates stagnation in the American economy can prevent us from making those improvements in our industrial productivity that are so desperately needed if we are to remain competitive in the international markets of the world.

History reminds us that even in the worst days of the great depression there was never a shortage of experts to warn against all curative public actions, on the ground that they were likely to create a problem of inflation. Had this counsel prevailed here, as it did in pre-Hitler Germany, the very existence of our form of government could be at stake. No modern government will make that mistake again.

IV. GENERAL POLICY RECOMMENDATIONS

8. *Introduction.*—The two principal governmental weapons to combat recession and slackness are fiscal (i.e., tax and expenditure) policy and monetary or credit policy. In ordinary times both should be pushed hard, so that they are reinforc-

ing rather than conflicting. These are not ordinary times. Until our new programs have taken effect. America does not have the freedom from balance-of-payments constraints that she enjoyed for the 25 years after 1933.

The usual balance between fiscal and monetary policies will have to be shifted in the period just ahead toward a more vigorous use of fiscal policy because of the international constraint. Some of the conventional mechanisms of credit policy may have to be altered to meet the new situation we face. While credit was made very easy in the 1954 and 1958 recessions in order to induce housing and other investment spending, a similar reduction of the short-term interest rate on Government bills down to the 1-percent level might lead in 1961 to a further movement of international funds to foreign money markets, thereby intensifying our gold drains. Because our monetary institutions are slowly evolving ones, the following recommendations deal less fully with monetary policy than the subject deserves in a full-scale study of stabilization.

9. *The need for flexibility.*—Since experience shows that no one can forecast the economic future with pinpoint accuracy, the policymaker cannot plan for a single course of action; he must be prepared with a list of programs, reserving some on the list for the contingency that events in the early months of 1961 may turn out somewhat worse than what today seems to be the most likely outcome. The following recommendations of this report, therefore, fall into two parts.

First come those minimal measures that need to be pushed hard even if the current recession turns out to be one that can be reversed by next summer at the latest. Expansions and accelerations in expenditure programs that are desirable for their own sake, improvements in unemployment compensation, new devices that permit use of flexible credit policy within the international constraints and stimulus to residential housing are examples of measures that belong in our first line of defense and which are already seen to be justified by what we know about the recent behavior of the American economy. Now in January the wisdom of such policies can already be verified.

Second comes a list of other measures of expansion which represent sound programs to combat a sagging economy, but which are more controversial at this time. If we could read the future better, they might be just what is now needed. But given our limitations, it may be safer to hold such measures in reserve. As the months pass, and the February and March facts become available, we shall be in a position to know whether more vigorous actions are called for. Flexibility in decision making deserves emphasis: There is nothing inconsistent about asking for measures in March that one does not ask for in January, if events have provided us with new information in the meantime. The annual budget should itself be a "living document." Just as Congress should begin to explore measures that will enhance the flexibility of tax rates by giving certain discretionary powers to the Executive, so should Congress itself be quite prepared to flexibly reverse its field in tax legislation when new economic conditions are recognized to call for new measures.

10. *Important warnings.*—It is just as important to know what not to do as to know what to do. What definitely is not called for in the present situation is a massive program of hastily devised public works whose primary purpose is merely that of making jobs and getting money pumped into the economy. The Roosevelt New Deal inherited a bankrupt economy that was in desperate straits. Whatever the wisdom of antidepression make-work projects in such an environment, they are definitely not called for at the present time. There is so much that America needs in the way of worthwhile governmental programs and modern stabilization has so many alternative weapons to fight depression as to make it quite unnecessary to push the panic button and resort to inefficient spending devices.

Similarly, as was mentioned earlier, massive spending programs designed to undo in a year the inadequacies of several years do not represent desirable fiscal policy. Planned deficits, like penincillin and other antibiotics, have their appropriate place in our cabinet of economic health measures; but just as the doctor carries things too far when he prescribes antibiotics freely and without thought of proper dosage, so too does the modern government err in the direction of activism when it goes all out and calls for every conceivable kind of antirecession policy. The golden mean between inaction and overaction is hard to define, and yet it must be resolutely sought.

Finally, it is worth repeating the warning against concentrating exclusively on ending a downward slide of activity and ignoring the suboptimal level at which the economy may then be operating. Even if this recession ended early in 1961, and even if its initial stages seemed to show a tolerable rate of improvement, that would not alone be enough to render unnecessary policies aimed to get us back to, and keep us at, high employment levels. Satisfactory growth is not something one procures by a once-and-for-all act; eternal vigilance, as with so many other good things, is the price that must be paid for good economic performance.

V. "FIRST LINE OF DEFENSE" POLICIES

11. *Expenditure programs.*—Pledged expenditure programs that are desired for their own sake should be pushed hard. If 1961–62 had threatened to be years of over-full-employment and excessive inflationary demand, caution might require going a little easy on some of them. The opposite is in prospect. The following measures are not being advocated in the faith that they will help business from declining in the first months of the new year. Some of them will, at best, pay out money only after a considerable delay. They are advocated for their own sakes as builders of a better, fairer, and faster growing economy. And even should their expenditures come into play after we have reversed the recession tide, they should be helpful in making the next recovery a truly satisfactory and lasting one.

(i) Defense expenditures ought to be determined on their own merits. They are not to be the football of economic stabilization. Nor, as was so often done in the past, ought they to be kept below the optimal level needed for security because of the mistaken notion that the economy is unable to bear any extra burdens. Certainly a recession drop in tax receipts should not inhibit vital expenditures any more than should the operation of artificial limits on the public debt. And they should certainly not be maintained at high levels merely for the purpose of substitution for other measures designed to keep employment high. On the other hand, any stepping up of these programs that is deemed desirable for its own sake can only help rather than hinder the health of our economy in the period immediately ahead.

(ii) Foreign aid is likewise to be determined by the need for development abroad. An increase in this program, skillfully tailored to take account of the international payment position, deserves high national priority in a period like this one.

(iii) Education programs including funds for school construction, teachers' salaries, increased loans for college dormitories should be vigorously pushed. Some of these could have an impact even within calendar year 1961 itself.

(iv) Urban renewal programs, including slum clearance and improvement of transportation facilities, represent desirable projects that should come high on the policy agenda.

(v) Health and welfare programs, including medical care of the aged, increased grants for hospital construction, and continued large grants for medical research, are desirable even though some of them—such as health for the aged financed by social security—will not add at all to dollar demand in the near future.

(vi) Improved unemployment compensation is one of the most important of all the measures on this list from the standpoint of antirecession action. The fairest and most effective step the Federal Government can take to help fight the recession would be to expand unemployment compensation benefits. Such expenditures go to those who need them and who will spend the money promptly; they also go up at the right time and in the right place and will come down at the right time and in the right place. It is a sad fact, however, that the Nation's unemployment compensation system cannot possibly do the job it is expected to do. Under present arrangements, it was shown to be inadequate in the 1957–58 recession and it will be inadequate in the present recession as well.

For the immediate future, emergency legislation is needed to permit all States to continue paying unemployment benefits (perhaps at a stepped-up rate) for at least 39 weeks, regardless of the condition of their insurance reserves and even if they have not yet repaid the loans received to tide them over in 1958.

For the long pull, we need a system with basic Federal standards that will (*a*) cover employees in all firms regardless of size; (*b*) provide unemployment benefits of at least one-half of the employee's earnings; and (*c*) extend the term of benefits to a minimum of 26 weeks in all States, supplemented by an additional 13 weeks during periods of high national unemployment. Federal standards are also needed to provide for adequate financing and solvency of the system. Consideration should also be given to the possibility of equalizing the burden of financing unemployment benefits among the States, and to varying the benefits in such a way that they will go up when unemployment in the Nation as a whole is high and go down when unemployment is low. These measures would reinforce the stabilizing effectiveness of the system in all stages of the business cycle and would eliminate the need for hasty action during periods of emergency.

(vii) Useful public works programs should be accelerated to the extent feasible without disrupting their orderly execution. This applies to Federal and federally supported programs, such as (*a*) water resources, (*b*) highways, (*c*) post office construction, (*d*) public building construction by the General Services Administration, and (*e*) military construction. Prompt additional appropriations and authorizations by the Congress are needed in most cases. Opportunities for speeding up authorized public works exist also at the State and local levels. Cooperation of all levels of government strengthens an antirecession program.

(viii) Highway construction programs can be accelerated. Cement capacity and labor availability is such as to make this a potent near-term stimulant. An aggressive Federal highway program might involve any of the following measures: (*a*) relaxing contract controls over State obligations, and assuring States their obligations will be met: (*b*) authorizing repayable advance to the States to meet their 10-percent matching requirements under the interstate program; (*c*) waiving the pay-as-you-go amendment if required to permit full apportionment of future interstate authorizations and, if deemed necessary, increase these authorizations.

(ix) Depressed area programs are desirable both in the short run and the long. The Douglas report spells out needs in this matter and makes comment unnecessary here.

(x) Natural resource development projects, including conservation and recreation facilities, provided further examples of useful programs.

The above list does not pretend to be exhaustive. Certain other expenditure measures could be added to a first-line-of-defense program, but enough has been said to indicate the nature of the needed actions. The order of magnitude contemplated here might be in the neighborhood of $3 to $5 billion above already planned programs in fiscal 1962 and does not involve the inflationary risks of an all-out antirecession blitzkrieg. This does not purport to make up for the accumulative deficiencies in those vital areas.

12. *Residential housing stimulus.*—The last two recessions were helped immensely by a successful program to make credit more available to residential housing. No experts could have predicted the anticyclical potency that housing has shown in the postwar period. Already we have seen some easing of credit in this area, but such steps do not seem this time to have been so successful in coaxing out a new demand for home construction. There is perhaps some reason to fear that less can be expected from the housing area in the year ahead. Downpayments are already quite low, as are monthly payments. Vacancy rates, particularly in certain areas and for certain types of housing have been rising. The age brackets that provide the greatest demand for new housing are hollow ones because of the dearth of births during the depression of the 1930's.

Nonetheless, so great is the need for housing a few years from now when the wartime babies move into the house-buying brackets and so useful is the stimulation that a resurgence of housing could bring that it would seem folly not to make a determined effort in this area. In particular, loans for modernization of homes, which now bear so high an interest rate might provide a promising source for expansion.

Many specific actions will be required. Mortgage rates might be brought down to, say, 4½-percent interest, with discounts on mortgages correspondingly reduced; consideration might be given to further extended maximum amortization periods. The insurance fee for single dwellings under FHA programs might well be reduced from one-half to one-quarter percent. The Federal National Mortgage Association (FNMA or "Fannie Mae") could step up its mortgage purchasing program, especially for high-risk mortgages lacking private markets. Housing for the elderly is another program, desirable for its own sake. Measures that tie in with urban renewal and college dormitories, as covered above, also hold out promise.

Particularly because our international balance of payments inhibits certain types of activistic monetary policy will it be necessary to push hard on specific credit programs in the housing field. Innovation, ingenuity, and experimentation with new instrumentalities will be needed in this matter; it is not reasonable to believe that the patterns earlier arrived at are the last word in feasible programing

13. *The role of monetary policy.*—Were it not for the international constraint, an economy that faced recession in the short run and which had been falling below its potential for several years would naturally call for a considerable easing of credit. Indeed a growth-oriented program would entail a combination of low-interest rates and widely available credit with an austere fiscal program designed to create budget surpluses large enough to offset any resulting overstimulation of demand. But such a program must await a solution of our international economic difficulties that will free our hands in domestic monetary policy.

The first order of business is to get nearer to high employment. Expansion by the Federal Reserve of bank reserves, in order to increase the supply of money and to stimulate investment spending, will naturally tend to lower short-term interest rates. But in view of the volatility of funds as between our money markets and those abroad which pay higher interest, we can plan only limited use of this conventional mechanism. New exploration is needed.

(i) In the days after the 1951 accord when the lesson had to be learned that Government bonds were not in peacetime to be arbitrarily pegged at artificial price levels, it was perhaps defensible for the monetary authorities to concentrate almost wholly on open-market operations in the shortest term Government securities. Without entering into the merits of this position—and the problem is indeed anything but a simple one to be decided by emotional slogans—responsible economists realize that the new international situation requires some change in emphasis. Indeed it is encouraging to note that the Federal Reserve authorities have themselves already been experimenting with actions designed to adjust to the new situation. Still further actions may be desirable in order to help bring long-term interest rates down relative to short-term. It is long-term rates which are most decisive for investment spending; and it is short-term interest rates that are most decisive for foreign balances. This is not an area for hasty improvisation or doctrinaire reversal of policies; but it is one for pragmatic evolution of procedures and policies.

Nor is this merely a task for the Federal Reserve. The Treasury too must consider the wisdom of relying primarily on short-term issues in the period just ahead. Those in Congress who have thought that recession times are the best period in which to issue long-term debt at low interest rates will have to go through the same agonizing reappraisal of their view as a result of the new international situation.

The whole problem of debt management by the Treasury, as coordinated with the Federal Reserve in the interest of overall stability, will require rethinking in these new times. No conflict of desires between the Executive and the Federal Reserve is to be involved, since both have the same interest in economic recovery and defense of the dollar.

(ii) Decisive actions to improve our international balance-of-payments position are desired for their own sake as well as to liberate domestic stabilization policies. This is not the place to describe the numerous programs that are needed in the international area. Fortunately, there are some reasons to think that our net export position is an improving one and that the task is not an impossibly difficult one. The primary need is to make sure that our productivity is improved so that our costs will remain competitive in international markets. But there are also certain measures that can alleviate the psychological drain on gold.

VI. "SECOND LINE OF DEFENSE" POLICIES

14. *Two alternatives.*—All the above has been premised upon a specific, and perhaps optimistic, forecast of how the economy is likely to behave in 1961. This first alternative could be called the "optimistic model" were it not for the fact that it turns out to involve unemployment that does not shrink much or any in 1961 below present levels of some 6 percent. It seems nevertheless to agree most closely with the likeliest expectations revealed by a careful canvass of economic forecasters in business firms, universities, and public agencies.

Concretely, the optimistic model assumes that the gross national product will decline for at most one or two quarters. It assumes that the calendar year GNP will average out to between $510 and 515 billion, which represents an improvement in real GNP of about 2 percent in money terms and 1 percent in real terms (after correction for price changes has been made). It assumes that by the end of the year the economy will be running some 3 percent above the present rate. It assumes that even in the absence of any needed programs by the new administration the current budget will have lost its surplus and more likely will show some deficit. It assumes that our new jobs will be barely enough to provide work for the 1.2 million workers who are added to the labor force in 1961 and that unemployment remains a grave social problem.

Evidently such an outlook cannot be regarded as an optimistic one; and it is to improve upon this situation that the above programs were prescribed.

It is only wise, though, to be prepared for an even worse outlook. Suppose inventory decumulation continues longer than expected above; that consumers continue to save as large a percentage of their disposable income as they have recently been doing; that plant and equipment expenditures by business accelerate their downward slide; and that construction generally proves to be disappointing. What then?

In that case unemployment will rise toward and perhaps beyond the critical 7½-percent level that marks the peak of the postwar era. In that case corporate profits will sink far below their present depressed levels, and a sagging stock market may add to the public's feeling of pessimism. In that case we shall certainly automatically incur a large deficit. While many hope and expect this more pessimistic model will not happen, it cannot be ruled out by careful students of economic history and present indications.

15. *A temporary tax cut.*—If economic reports on business during the early months of the year begin to suggest that the second, more pessimistic outlook, is the more relevant one, then it will be the duty of public policy to take a more active, explansionary role. This is not the place to spell out the details of such a program. But certainly the following tax-cut measure will then deserve consideration.

A temporary reduction in tax rates on individual incomes can be a powerful weapon against recession. Congress could legislate, for example, a cut of 3 or 4 percentage points in the tax rate applicable to every income class, to take effect immediately under our withholding system in March or April and to continue until the end of the year.

In view of the great desirability of introducing greater flexibility into tax rates, it would be highly desirable for Congress to grant to the Executive the right to continue such a reduction for one or two 6-month (or 3-month) periods beyond that time (subject to the actions being set aside by joint resolution of Congress) with the clear understanding that the reduction will definitely expire by the end of 1962.

At this time it would be urgently important to make sure that any tax cut was clearly a temporary one. With the continued international uncertainty and with new public programs coming up in the years ahead, sound finance may require a maintenance of our present tax structure and any weakening of it in order to fight a recession might be tragic. Even if it should prove to be the case that growth makes reduction of tax rates possible in the long run, that should be a decision taken on its own merits and adopted along with a comprehensive reforming of our present tax structure. (Various tax devices to stimulate investment might also be part of a comprehensive program designed to eliminate loopholes, promote equity, and enhance incentives.)

VII. A FINAL CAUTION

16. *Direct attack on the wage-price spiral.*—The above programs have been primarily concerned with fiscal and monetary policy. This is as it should be.

It is important, though to realize that there are some problems that fiscal and monetary policy cannot themselves come to grips with. Thus, if there is indeed a tendency for prices and wages to rise long before we reach high employment, neither monetary nor fiscal policy can be used to the degree necessary to promote desired growth.

What may then be needed are new approaches to the problem of productivity, wages, and price formation. Will it not be possible to bring Government influence to bear on this vital matter without invoking direct controls on wages and prices? Neither labor, nor management, nor the consumer can gain from an increase in price tags. Just as we pioneered in the 1920's in creating potent monetary mechanisms and in the 1930's in forging the tools of effective fiscal policy, so may it be necessary in the 1960's to meet head on the problem of a price creep. This is a challenge to mixed economies all over the free world, and is not to be met by Government alone.

OFFICE OF THE WHITE HOUSE PRESS SECRETARY

THE WHITE HOUSE

JANUARY 25, 1961.

The President met this afternoon with a special committee that he had selected, several weeks before his inauguration, to analyze the current economic position of the United States, with special attention to the balance of payments.

The Secretary of the Treasury, Douglas Dillon, was also present. The committee consisted of Allan Sproul, former President of the Federal Reserve Bank of New York, Roy Blough, professor of international business, School of Business Administration, Columbia University; and Paul W. McCracken, professor of business conditions, School of Business Administration, University of Michigan. Professor Blough served as a member of the President's Council of Economic Advisers during the administration of President Truman; Professor McCracken served on the Council for a time under the administration of President Eisenhower. The committee completed its report on January 18.

The President today thanked the committee for preparing this excellent report, which he found very useful. He believes that it should contribute greatly toward better public understanding of the nature of the current recession, the gold outflow, and our international payments deficit. He is hopeful that it will stimulate wide public discussion of the more important measures for dealing with these problems. He felt that the report and its recommendations for positive action merited close attention.

JANUARY 18, 1961.

DEAR MR. KENNEDY: We transmit, herewith, the report which you requested on the current economic situation in the United States, our international balance of payments, and the decline in our gold stocks, together with suggestions for action to help reverse the downward trend in the economy, strengthen the balance of payments position, and make clear to the world the basic strength of the U.S. dollar. Our suggestions will be found beginning at page 14 of the report.

We hope that our analyses and suggestions will be helpful to you and to your associates in the Government, and we appreciate having had this opportunity, as private citizens, to make a contribution to the consideration of economic policy at this difficult time.

Respectfully,

ROY BLOUGH,
PAUL W. MCCRACKEN,
ALLAN SPROUL, *Chairman.*

THE ECONOMIC SITUATION AND THE BALANCE OF PAYMENTS

You have asked us to give you our views as to the state of the domestic economy and this country's international balance of payments, to suggest measures of public policy which will help in reversing the present downward trend of the economy and the upward trend of unemployment, which will do this in ways conducive to long-term economic vigor, and in ways which will strengthen, not weaken, our balance of payments position.

This is a difficult assignment and we have not tried to achieve novelty nor to review many aspects of our economic situation which have become familiar ground. We have tried to achieve that measure of objectivity and freedom from partisan spirit which you requested of us.

Before moving into the body of our statement, it may be helpful to tell you how we have conceived the structure of the statement and to mention two or three broad general opinions which we hold, which have consciously colored our analysis and helped to form our opinions.

The first section of our review is concerned with the domestic economy. In the short time which we have had to prepare this summary report, and in view of the Government and private work which is continuously going forward in this field, we have felt that we could start with a statement of where we are now and where we seem likely to be going, without stopping to try to indicate in detail how we got here. This helps to bring our task within the limits of our time and space.

In the second section of our review relating to the balance of payments, however, we saw a need to assembled the data of the recent past in order to try to understand our present position. The emergence of this aspect of our affairs from the obscurity of three decades of less than urgent attention has brought more workers to the field and shed some light on the problems which it poses, but there is still less public understanding of its meaning than is true of our domestic economic situation. We have, therefore, tried to describe the nature of the problem of the balance of payments, to appraise its significance and to explore the likely course of developments in the near-term future.

In the third section of our review we addressed ourselves to the intricate task of suggesting lines of action that would be helpful in attempting to cope, simultaneously, with present sluggishness in the domestic economy and weakness in the balance of payments. It is necessary that these two areas of our economic existence be considered together. We all now have some awareness of the fact that the position of our international balance of payments conditions the measures which we can successfully adopt in treating domestic economic problems, particularly when the domestic economy is in recession.

Our suggestions relate primarily to fiscal policy, monetary policy, price and cost policy, and foreign economic policy, all of which have to bear some of the burden of improving economic conditions at home and supporting the prestige and power of the United States around the world.

It is in preparation for an understanding of our welding together of the national and international aspects of problems and polices, that it may be helpful to specify certain broad general opinions which have conditioned our approach.

Economic growth

Whatever the longer future may hold in terms of the rate of growth of real product of our economy per capita, and we would hope that it can gradually be accelerated, this is not the answer to our clear and present problems at home and abroad.

Fiscal policy

We think that fiscal policy, despite certian elements of inflexibility, must play an enlarged role in modifying swings and trends in our economy, and that in seeking to have it play this role the Federal budget should move around balance, not always remain in balance. If the compensatory character of the budget is to be maintained, however, it should be in surplus during times of maximum employment and production as well as in deficit during times of recession; this requires control of expenditure when revenue is coming in strongly even more than when revenues are delcining, if we are to avoid an alternation of poorly timed slim surpluses and poorly timed excessive deficits.

Monetary policy

We believe that monetary policy may have been asked to play too large a role in combating cyclical variations in economic activity and secular trends which have had some of their roots in structural defects and structural developments. and in fiscal deficiencies. We also believe, however, that monetary policy is of key importance in the present situation which involves compatibility of domestic programs and international finacial relations.

Balance of payments

We do not think that the limits now imposed on our domestic freedom of action by our balance of payments position is a factor which involves countenancing continued high unemployment or which prevents constructive action to promote domestic economic recovery. The restraints of our balance of payments position, presently accentuated by temporary influences, are such as should help to keep undesirable domestic trends from developing to or beyond the point of no return.

THE DOMESTIC ECONOMIC SITUATION

The year 1961 opened against the backdrop of a slow decline in production and disappointing developments in employment that had begun about mid-1960. The total output of goods and services is estimated to have been at an annual rate of $503.5 billion in the fourth quarter of 1960, or 0.3 percent below the second quarter peak.

The current recession is more clearly visible in industrial output and in unemployment. As measured by the Federal Reserve's index, industrial production retreated from its momentary peak early in 1960 to a plateau which was reasonably well sustained until about midyear. Then a decline began, and from May to the end of the year the index of industrial output moved downward 5.8 percent. The decline, as usual, was sharper for the heavy goods lines, but most of the major lines of industrial activity, by the yearend, had reduced their rates of operation.

As activity declined, work forces were also reduced. Apart from the usual seasonal changes, nonagricultural employment began to weaken after July, with the declines in December being particularly large. As the year closed there were 921,000 fewer people at work than at midyear.

With the labor force continuing to grow, the moderate decline in the number of jobs available gave rise to a persistent increase in unemployment. By the year end 4.9 million were unemployed, or 6.8 percent of the entire labor force on a seasonally adjusted basis. The impact of this unemployment was quite uneven among the various groups comprising the labor force. Job opportunities remained generally ample for technical and professional workers, while the rate of unemployment among the semiskilled and unskilled by the end of the year exceeded 10 percent, and new entrants to the labor force were having increasing difficulty finding or holding jobs. In a dynamic, fast-moving economy there will always be a number of people unemployed in the technical or statistical sense, even if job opportunities are abundant. But the 6.8 percent of our work force unemployed at the end of 1960 would substantially exceed what might be considered a normal minimum.

What is a reasonable expectation about economic developments in the year ahead? The shape of even near-term business prospects is always shrouded with uncertainty, and visibility is particularly murky during a business decline. On the other hand changes in economic policy require time to exert their influence on business conditions. An economic program appropriate and necessary, if a substantial further and possibly cumulative contradiction otherwise seemed probable, would be ill advised if a prompt improvement in economic conditions were a reasonable expectation. Good policy requires, therefore, that we formulate a tentative judgment about what the facts and evidence now seem to indicate about the probable shape of economic developments in 1961. At the same time we must stand ready to modify, promptly, our diagnosis and our policies as new evidence becomes available.

Weaknesses in the economy

There are some fairly clear minus signs as we look ahead at economic prospects. For one thing we are particularly disturbed by the sharpness of the declines in employment an incomes from November to December. The declines were considerably larger than in the other months of the recession. This is not an unusual experience even in a mild recession, but until the upturn begins it must remain a source of concern.

Businesses are curtailing their expenditures for machinery, equipment, and new facilities, and an upturn in such outlays is not imminent. Indeed, surveys indicate that businesses are planning some further reductions this year, though the planned reductions are markedly less than those at the same point in the 1957–58 recession. Capacity is generally ample, since operating rates ars substantially below those that make the most efficient use of facilities. And the marked decline in corporate profits, has reduced both the incentive and the means to maintain or expand these capital outlays.

Production schedules have now been pulled below current rates of demand for output, as businesses have taken steps to prune inventories. In both the 1954 and the 1958 recessions the liquidation of inventories ran for about a year (though, in the final stages, the liquidation reflected tardy increases in production in response to unexpected strength in sales). Since, this time, inventories began to decline last July, it seems reasonable to assume that this liquidation will continue for a few months.

Because of the very large increase last year in our exports, it is doubtful if we can expect our foreign trade to contribute further to economic expansion in 1961. There could be a moderate decline in our very large net export surplus as our imports respond to an improvement in business conditions here.

Residential construction has been disappointing in recent months. The response to easier credit conditions seems to have been somewhat slower and weaker than in the recessions of 1953–54 or 1957–58.

Sources of current economic strength

The current economic situation also has its pluses. In spite of sharp declines during December, the recession thus far has been a relatively mild one. The declines in measures of business conditions generally have been less than during periods of comparable length in the two preceding recessions. (See following table.) Usually the magnitude of a decline at this stage in a recession is a good clue to its ultimate severity. We must be on the alert for unexpected developments, but so far the current recession has not developed in a way suggesting a cumulative, further severe decline in business activity.

Government units at all levels will be increasing their expenditures through the year. State and local governments have been quite responsive to the pressing need for the facilities and services for which they are primarily responsible, increasing their outlays recently at the annual rate of 8 to 10 percent. Something like this increase seems evident for the year ahead. And it seems probable that the rise in Federal outlays will be somewhat more than the increase during the last year.

If our appraisal up to this point is realistic, purchases of goods and services by consumers should continue at about current levels, with the probability of some increases after the early part of the year. Employment will continue high, though there will be slack in the labor force. Consumers' incomes after taxes have been well-maintained even during the recession. The moderate extent of the rise in consumer borrowing last year, and the present credit conditions, mean that financing will be readily available for the purchase of houses and other items of consumer capital goods. While empirical evidence bearing on the buying intentions and attitudes of consumers does not suggest bullish sentiment, neither is there evidence of such a plunge in consumer confidence as had already occurred at this stage of the last recession. Intentions to buy have dropped somewhat below year-earlier levels, but attitudes generally (as measured by surveys) indicate that basic confidence has not deteriorated significantly from that of last summer.

Percent changes in economic indicators during the first 6 months of 3 postwar recessions

Indicator	1953–54	1957–58	1960–61
Gross national product, 2 quarters	−1.9	−3.6	−0.3
Nonagricultural employment—Census Bureau	−1.9	−1.5	−1.8
Nonagricultural employment—Bureau of Labor Statistics	−2.0	−2.3	−1.7
Unemployment	+81.7	+35.6	+29.9
Hours worked per week—manufacturing	−2.7	−3.0	−3.8
Personal income	−0.9	−0.5	+0.2
Retail sales	−4.4	−1.4	−1.1
Industrial production	−9.0	−9.7	−5.9
Money supply (demand deposits and currency)	+0.3	−0.9	+0.4
Consumer price index [1]	0.0	+0.7	+0.7
Commercial and industrial construction contracts (floor space)	−43.3	−8.7	+5.6
Housing starts—private nonfarm	+1.9	−1.0	−21.9
New orders—manufactured durable goods [1]	−17.5	−13.2	−5.7
Industrial raw materials prices	−5.6	−10.6	−6.7

[1] Because of slower reporting, these data cover 5 months.

NOTE.—Percentage change from May–July average to December in 1960, compared with changes during comparable periods in 1953–54 and 1958–59. All figures are seasonally adjusted except prices.

The volume of output moving into the hands of ultimate users has continued to increase throughout the recession, and is in excess of current rates of production. This rate of "final demand" increased $3.3 billion from the second to the third quarters last year, and another $4.1 billion in the final quarter. This contrasts with our experience in 1957–58 when by this stage of the recession the final demand for output was declining. If this basic demand holds, or continues to edge upward, it is reasonable to expect that production should soon begin to stabilize, then gradually advance to rates at which goods and services are being purchased.

The outlook for 1961

What does this analysis indicate for the probable course of economic developments during the year ahead? The evidence available to us in January suggests two conclusions as bases for economic policy in the months ahead. First, the current contraction still appears to be in the family of the relatively mild recessions that have characterized the postwar period. It does not yet look like a cumulative, severe recession. Second, we must assume that the decline in business activity has further to run, though the bottom of the recession could turn out to be not very far below the current level of business activity.

Even if we are not too far from the low point, are we probably going to have a delayed or weak upturn and recovery? This is a question that understandably is of considerable concern, though one that cannot and need not be given a conclusive answer at this point.

Clearly there are no obvious things that guarantee a strong upsurge, such as deferred demands for automobiles, a heavy expansion in housing, or quite large increases in Government spending. Experience, however, teaches us to be cautious about assuming that elements of strength will not be present during the next upturn just because they were not clearly visible during the preceding recession. Three years ago there was also considerable pessimism engendered by the absence of obvious sources of major strength; yet the economic situation turned around fairly early in the year and moved upward vigorously for a time.

It may be useful, in attempting to gage the probable vigor of the next upturn, to examine the course the economy has traced out in these other similar periods. In the year following the low quarters in 1954 and again in 1958 gross national product increased somewhat over 9 percent. Even if the force of the upturn, this time, should turn out to be somewhat less than in these earlier periods, and there is as yet no certainty about this, our output of goods and services by the end of this year should be measurably above that of the final quarter of 1960.

Would this be a good performance for the economy in 1961? In a very real sense, this question must be answered in the affirmative. It would mean that the contraction in business activity would have been small, and that business conditions during much of the current year would be improving. On the other hand it would also mean that the year would be one of continued slack in the labor force, with employment even by the end of 1961 still short of what would be needed to provide reasonably full utilization of our productive resources. This would be true because the labor force will expand by perhaps 1 to 1½ percent, productivity should rise, and we begin with some slack in employment. Unemployment would be declining, but it would still be above normal minimum levels, and it would still pose an important problem of economic growth and human welfare.

The present domestic economic situation and an assessment of its immediate prospects, then, seem to call quite simply for expansionist economic policies. At this point, however, we confront another and for this country a new problem in the consideration of policies to expand the domestic economy, namely, the disequilibrium in our balance of payments. Can we afford to adopt policies that would have the effect of enlarging the demand for output? Would a policy of economic expansion further aggravate the substantial excess of payments to the rest of the world over our receipts—with possibly a loss of gold at an increasing rate? These are the questions we have been asking ourselves as a nation. And in making suggestions about the structure of an appropriate economic policy for this country in 1961, clearly we must take into account this disequilibrium of recent years in our balance of payments. It is to this matter that we now turn.

THE DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS

In the present system of international trade and finance, the United States plays the dual role of trader and banker. Because it is the world's most powerful trading nation, it has consistently taken the lead in establishing conditions for the vigorous expansion of international trade throughout the free world. In its role as banker for the world, the United States has made billions of dollars freely available to serve as monetary reserves for other countries. In both these roles, as trader and as banker, the United States has a commitment to the promotion of liberal trading practices, and to a strong and stable international financial structure.

With the remarkable recovery and expansion of the rest of the industrialized world, during the past decade, the United States can no longer take for granted, however, the automatic fitting together of its trading position and its banking responsibilities. This means it must be concerned with the size and frequency of whatever deficits occur in its balance of payments. The cumulative force of developments has now clearly brought into view a new position, and the need for new decisions in the formulation of public policy—the recognition that, in general, our performance as a trader and our performance as a banker must be reconciled with a balance-of-payments position that will support both roles. We have not reached a crisis. We have reached a turning point in our world economic position, one that calls for fresh analysis and determined action. The objective, of course, is to play our proper part in the preservation of a growing system of free trade and payments in the world at large. Our pivotal place in that system calls for more exacting choices, but it also provides the prospect of greater opportunity, in helping to strengthen economic and financial ties among the countries of the free world.

Here then, are the facts which must be faced.

With the exception of the year 1957 the United States has had a deficit in its balance of international payments in every year since 1949. For the whole 11-year period, 1950–60, the cumulative net deficit was $21 billion, an average of nearly $2 billion a year. The present concern with the balance of payments is related particularly to the fact that half of the total deficit was experienced in the most recent 3 years, 1958–60, and that during this period there was an outflow of gold of nearly $5 billion.

The recent general pattern of the U.S. balance of payments includes a large surplus in the current account (goods, services, and investment income), while both the private capital account and the Government account usually show deficits which, together, have exceeded the current account surplus, resulting in a final net deficit. The combination of conditions has changed from year to year, and although the final size of the deficit was nearly the same for 1958, 1959, and 1960, the particular classes of transactions giving rise to the deficits were markedly different, as is seen when the balance of payments statement is examined in detail.

U.S. balance of payments, 1950–60

[Algebraic signs denote receipts or payments in millions of dollars]

Transaction	1950-52 average	1953-55 average	1956	1957	1958	1959	1960 (estimate)
Merchandise exports	+12,518	+13,119	+17,379	+19,390	+16,263	+16,225	+19,500
Merchandise imports	−10,382	−10,956	−12,804	−13,291	−12,951	−15,315	−15,000
Trade balance	+2,137	+2,163	+4,575	+6,099	+3,312	+910	+4,500
Services and investment income (net) [1]	+1,244	+1,339	+1,591	+2,174	+1,650	+1,305	+1,084
Total current account	+3,381	+3,502	+6,166	+8,273	+4,962	+2,215	+5,584
Private capital account	−1,039	−801	−2,460	−2,814	−2,820	−1,753	−3,100
U.S. Government account:							
Military spending abroad	−1,268	−2,653	−2,955	−3,165	−3,412	−3,090	−3,000
Grants	−2,826	−1,795	−1,733	−1,616	−1,616	−1,623	−1,384
Net loans [2] [3]	−244	−145	−629	−958	−971	−358	−800
Total U.S. Government account [3]	−4,338	−4,593	−5,317	−5,739	−5,999	−5,071	−5,184
Balance on recorded transactions	−1,996	−1,892	−1,611	−280	−3,857	−4,609	−2,700
Unrecorded transactions	+315	+303	+643	+748	+380	+783	−800
Overall balance	−1,681	−1,589	−968	+468	−3,477	−3,826	−3,500
Means of settlement:							
U.S. gold sales or purchases (−)	+437	+500	−306	−798	+2,275	+731	+1,668
Change in foreign liquid dollar holdings [4]	+1,244	+1,089	+1,274	+330	+1,202	+3,095	+1,832

[1] Includes pensions and private remittances and excludes military expenditures.
[2] New loans minus repayment of loans.
[3] Excludes subscriptions to international financial institutions.
[4] Includes foreign holdings of all short-term assets, plus U.S. Government notes and bonds.

NOTE.—Military aid grants and associated exports of goods and services are excluded. Components may not add to totals because of rounding.

Current account

In 1960, the trade balance (merchandise exports minus merchandise imports) showed an estimated surplus of $4.5 billion, compared with $0.9 billion in 1959, and $3.3 billion in 1958. These wide fluctuations in trade surplus were the consequence of changes in both exports and imports. In 1960, merchandise exports (excluding Government transfers of military materiel, since these do not affect the balance of payments) were an estimated $19.5 billion, a new all-time peak, compared with $16.2 billion in 1959 and $16.3 billion in 1958.

Shifts in the amounts of U.S. exports and in its export position, especially in 1959 and 1960, were greatly influenced by the comparative business conditions prevailing in the United States and in other countries. The good showing of 1960 was due at least in part to rapid economic expansion in much of Europe and Japan, while the U.S. economy was moving into a recession. There was also a diminution in the discriminatory restrictions imposed abroad against goods from the United States.

Merchandise imported by the United States (excluding military spending abroad by the Government) totaled an estimated $15 billion in 1960, compared with $15.3 billion in 1959, and $13 billion in 1958. During the course of 1960 the rate of imports decreased somewhat as business activity in the United States leveled off and declined. The receipts and payments on service transactions showed a net surplus for the United States over the 3 years, amounting to $1.1 billion in 1960, $1.3 billion in 1959, and $1.7 billion in 1958.

Private capital account

The private capital account includes the changes in U.S. private investments (direct business investment, stocks and bonds, loans, and deposits) that affect the balance of payments, as well as changes in foreign long-term investment here. Income of foreign business subsidiaries that is not declared as dividends does not enter into the U.S. international balance of payments.

The recorded net outflow of private capital was an estimated $3.1 billion in 1960, $1.8 billion in 1959, and $2.8 billion in 1958. There is reason to believe that the actual net outflow in 1960 was larger than this recorded amount of $3.1 billion. There are many transactions which the system of collecting information on international private capital movements does not reach; it is believed that changes from year to year in the amount of "errors and omissions" in the balance of payments statement are largely a reflection of such transactions. The estimated $1.6 billion change in errors and omissions, from +$0.8 billion in 1959 to —$0.8 billion in 1960, for example, may well represent, mostly if not entirely, capital outflow which should be added to the recorded net outflow for 1960, thereby possibly raising the figure for net private capital outflow to nearly $5 billion.

In its effect on the net deficit of the balance of payments, which declined only from $3.8 billion to $3.5 billion, the increase in private capital outflow from 1959 to 1960 nearly offset the dramatic improvement that took place in the current account surplus.

Most of the increase in private capital outflow was in short-term investments and can be attributed in considerable part to the higher short-term interest rates prevailing in Europe as compared to those in the United States. Interest rate differentials among countries shift from time to time, depending on business conditions and Governmental policies; consequently, outflows of such capital in some years may be expected to be followed by comparable inflows in later years.

Long-term investment abroad responds to different influences. The amount of direct business investment in plants, equipment, and working capital in foreign countries is affected primarily by profit opportunities, although the relative share of the financing done in the United States and other centers may be strongly influenced by comparative rates of interest. Over the 1950's the annual rate of direct U.S. business investments abroad increased from $0.6 billion in 1950 to a peak of $2.1 billion in 1957, after which it declined somewhat, amounting to an estimated $1.6 billion in 1960. Foreign direct investment has an adverse effect on the U.S. balance of payments when it takes place, but the adverse effect is less than the total amount of such investment.

Direct-investment enterprises abroad help the U.S. balance of payments in later years, if dividends and other earnings are transferred to the United States, but the foreign investment itself is not likely to be repatriated for a long time. Indeed, investment abroad is commonly followed by reinvestment of earnings, either in the country where they accrued or in third countries. In recent years a substantial part of the direct investment earnings of U.S. business in Europe particularly has not been transferred home and presumably has been reinvested abroad. Such reinvestment is encouraged by the tax laws of the United States, since if the investment is made through a foreign subsidiary, no U.S. tax is imposed until the earnings are paid to the American parent. The tax postponement provisions in this way also encourage the flow of new direct business investment abroad.

Government account

A major element in the balance of payments of the United States since the war has been Governmental loans and grants to foreign countries, together with U.S. military expenditures overseas. The total of grants, net loans (loans minus repayments), and military spending abroad amounted to an estimated $5.2 billion in 1960, $5.1 billion in 1959, and $6 billion in 1958. While the relative shares of different kinds of transactions have changed over the years, the total figure has remained fairly stable; compared with 1960 it was a little higher in 1949, lower from 1950 to 1955, and somewhat higher from 1956 through 1958. These Governmental transactions, accordingly, have not contributed to the enlargement, in recent years, of the deficit in the U.S. balance of payments, but they remain a continuing heavy charge on our international accounts in an increasingly competitive world economy.

Under present policy, a considerable part of the governmental grants and loans are spent directly for goods in the United States; the military expenditures abroad, however, result in placing unrestricted dollars in the hands of foreign holders.

The balance of payments outlook for 1961

The forces affecting the balance of payments are worldwide in character and include not only economic factors but also shifts in governmental policies of this and other countries. Moreover, since the balance of payments represents the residual settlement of offsetting transactions, its fluctuations show much greater amplitude than do the fluctuations in the transactions themselves. Accordingly, the balance of payments deficit or surplus that will be realized in any particular year is impossible to forecast with any degree of reliability.

We do believe, however, that with favorable circumstances a substantial improvement in the U.S. balance of payments may be realized in 1961. Even so, the problem of the "basic" deficit will remain. According to the best available evidence this basic or average expected deficit, with no change in our policies, would be about $2 billion.

The concern over the balance of payments

It was not until 1958 and thereafter that the deficit in the balance of payments came to be looked on as a matter for concern. In 1957 there had been a small surplus and an inflow of gold. The deficits of the earlier years had been welcomed as easing the "dollar shortage" and supplying other countries with badly needed monetary and foreign exchange reserves. The three large deficits of 1958, 1959, and 1960, accompanied by an outflow of gold totaling $4.7 billion for the 3 years, and amounting to $1.2 billion (excluding a special gold transaction) in the last 3 months of 1960, demonstrated that what had earlier been a source of benefit and strength to the rest of the world had now become, in the minds of many, a cause for questions and even of misgivings about the financial future of the United States.

One of the questions which recent experience has raised is whether the United States will be able to achieve viable equilibrium in its international payments position, without taking drastic steps such as increasing restrictions on imports, sharply reducing its worldwide military and economic programs, imposing exchange controls, or devaluing the dollar.

The special position of the United States in the world, which has resulted in the United States supporting large oversea military expenditures and grants for mutual defense, and loans and grants to promote economic stabiilty and development in other countries, and in encouraging a substantial flow of private foreign investment, places a heavy load on the U.S. balance of payments. To carry this load, and at the same time maintain equilibrium in its balance of payments, the United States is obliged to develop a current account surplus of proportionately greater dimensions than do most other countries and greater than the United States enjoyed in the prewar years.

The second question is whether the volume of liquid dollar liabilities of the United States is already so great that, in some period of low confidence and fiscal stress, the gold reserves of the United States might be insufficient to meet the demand for gold, necessitating exchange controls or even devaluation.

The fact that the United States is on balance a creditor nation, with a net international investment position that improved substantially during the 1950's, is no answer to the problem. The great bulk of U.S. assets abroad are privately owned, and are long-term investments, and some are payable in inconvertible currencies. They are not available to offset or repay short-term liabilities.

Both of these questions carry the implied misgiving that the United States might not continue indefinitely to honor its commitment to allow foreign governments and central banks to buy gold from the U.S. Treasury without limit or restraint at the present price of $35 an ounce—a cornerstone of our banking responsibility.

There is general agreement that the basic deficit in the U.S. balance of payments needs to be substantially reduced, because it would be risky to let our short term or liquid dollar liabilities rise indefinitely at the recent rate. Since we believe there will be no early need to increase international liquidity further, the goal of U.S. policy, at least for the near future, should be to demonstrate that the country can achieve balance-of-payments equilibrium on the average, although of course not in every year. This means that the United States needs to find ways of increasing its international receipts or decreasing its international payments, or some combination of the two, so that our international financial position will not continue to be clouded by the persistence of annual deficits of the magnitude of those experienced during the past decade.

This is not likely to be an easy task, in view of the increases in productivity in other industrial countries and the growing international competition for markets; but for a country with annual international transactions totaling more than $60 billion it ought to be well within our capacity to accomplish if each type of transaction makes a contribution.

The gold outflow

What gives the balance of payments outlook for 1961 its special significance is that we have now had 3 years of large deficits, leading to an outpouring of dollars which, in substantial amounts, have subsequently been converted into gold. While there is no fixed level at which our gold reserves become too small for our obligations, they clearly must be related to the operational needs of our role as the center of the free world's international gold exchange standard. That is why persisting deficits in the balance of payments which drain away our gold stock must be checked, and why the world must be shown that we can control our balance-of-payments position.

There has been some outflow of gold into the reserves of foreign central banks in all but 4 years since the end of 1949. Much of this was anticipated and desired. It has improved the distribution of gold among countries, and helped to make possible the restoration of a world of convertible currencies. It was not to be expected that a single country would continue to keep well over half the world's gold supply after the convertibility of major currencies was restored in an integrated international economy.

Even if the balance of payments were now in equilibrium, of course, this country would still be exposed to a banker's risk. The repatriation of funds by private foreign holders might result in a substantial outflow of gold, as such holders transferred dollar assets to foreign central banks, which might then buy gold from us. This is an old problem: It was not solved in the 1920's and still awaits solution.

But in the present state of disequilibrium of the balance of payments the risk is present, not potential. The most visible and publicily disturbing problem of recent months has been that various official foreign holders of dollars have come to prefer gold to increased dollar balances or, quite starkly, to prefer gold to dollars. An outflow of gold in the amounts and at the rate of recent movements could impair or destroy the ability of the U.S. dollar to serve as a principal world currency and thus break down the international monetary system which has been slowly and laboriously built up during the past 15 years, and which it is in the interest of all countries in the free world to maintain and strengthen.

Yet, paradoxically, it is the fear that such a breakdown might happen which has caused some central banks to seek to safeguard their reserve position and reduce the possibility of loss to their governments, and of criticism of themselves, if the dollar should be devalued, by increasing the ratio of their gold reserves to their dollar holdings.

The sense of uncertainty which this outflow created has also stimulated speculative private hoarding of gold and has resulted in gyrations in the price of gold on the London gold market, which strengthened speculative fevers and fears. U.S. gold has moved into private hoards abroad, through legal gold markets, when central banks have sold gold in these markets and replenished their holdings by buying gold from the U.S. Treasury.

At the end of 1960 free gold held by the United States was $6.2 billion, and its outstanding liquid dollar liabilities were an estimated $19.1 billion, not including dollar deposits and U.S. Government securities held by international financial institutions. The gold required by law to be held as a reserve against Federal Reserve currency and deposits was $11.6 billion and, if this requirement should be repealed, free gold holdings and total gold holdings would be the same. The usable gold stock would then be 93 percent of foreign short-term liabilities. This is a relatively large reserve and should be adequate to meet all demands as long as there is confidence in the dollar, since dollar balances have the advantage of earning a return while gold holdings are a charge on the holder. The fundamental interest of government and private citizens alike, in this country and abroad, in the proper working of an international monetary system, make it a first task of economic statesmanship to dispel present fears about the value of the dollar.

SUGGESTIONS

It has become clear to us as we have pursued this study, and we hope that this presentation will help to make it clear to you, that our present domestic economic situation and our balance-of-payments position will respond to firm action which is well within our means. No drastic programs are needed. The suggestions we make are addressed primarily to the current weakness in the near-term economic situation and in the balance of payments, but they would also strengthen the economy, and provide a base for improvement in the balance of payments, for the long pull. We are also convinced that the things which need to be done at home, and the things that need to be done with respect to our oversea financial and trade relations, are not mutually exclusive. In fact, if increased confidence in our strength here and abroad is taken into account, our actions may be mutually reinforcing.

Balance of payments

We address ourselves first to the balance of payments, not because this is the order of importance in these interrelated problems, but because it is here that public attention has become excessively concentrated and popular impressions may be most in error. We hold this view on three principal grounds.

First, insofar as any one category in the balance-of-payments accounting may be abstracted from the whole, without adjustment in other categories, it appears to be a fact that the conventional deficit figure in our balance of payments during recent months has been due most largely to an outflow of short-term funds.

Second, we surmise that the outward pull of these funds, by reason of the spread of short-term interest rates between domestic and foreign money centers, was made even more attractive by speculation and fears concerning the value of the dollar.

The covered spread between domestic and foreign short-term rates of interest already has declined from its recent peak, and we must avoid unnecessarily reversing this downward trend. The possibility that this gap will narrow further seems to be more than a hope in the light of what we deem to be the likely course of business developments here and abroad—a fairly early upturn here and, perhaps, some moderating of the boom in Western Europe and Japan.

Third, we cannot rely completely on all other categories of the balance of payments staying relatively favorable, however, and we cannot allow the dollar, the key currency of the free world, to remain as completely exposed as it has been to the interests, vagaries, and fears of a variety of holders of dollar balances at home and in foreign markets.

A program to meet our immediate problem, head on, recommends itself to us. It involves action or negotiation in four areas.

1. Psychologically, what is needed is a strong affirmation by the President in office that we are going to maintain the present gold value of the dollar, and that

we shall use whatever resources are necessary to this end; that we are not going to tinker with the dollar and that we are not going to interfere with the movement of funds between this country and foreign countries by way of exchange controls.

2. To support this declaration of intent we should remind our own nationals, and those of other countries, that we still have a large amount of free gold reserves (approximately $6.2 billion), that these reserves can be substantially increased by exercising our rights and privileges at the International Monetary Fund (up to possibly $4 billion), and that we have a "hidden reserve" in the form of the gold stock which is being held as backing for the note and deposit liabilities of the Federal Reserve banks (approximately $11.6 billion). The logic of the suggestion that these legal reserve requirements might now be revoked so that our reserves would be able to serve, unreservedly, in meeting temporary swings in foreign preferences for gold or dollars when our balance of payments is in deficit, is impressive. We do not think that a reduction or the elimination of these legal reserve requirements has become necessary, but we would support the action if the Government should decide that now is the appropriate time.

3. Actions which we think should clearly be taken now are:

(*a*) Pursue effectively the things which the previous administration has already ordered to conserve dollar expenditures abroad in behalf of our Armed Forces and in connection with our foreign economic aid programs. Since much of our foreign economic aid now takes the form of tied loans the principal benefit here should be found in our military expenditures.

(*b*) Pursue effectively removal of continued discriminatory practices of whatever kind which help to keep dollar goods out of foreign markets and foreign capital out of the United States. It is particularly important to try to prevent the Common Market concept, now taking form among various countries, from becoming a focus of trade discrimination unfavorable to us.

(*c*) Accelerate efforts to devise public action and induce private action which will create an export climate in this country and a competitive urge to profit by it, along with a recognition that increasingly intense competition from foreign producers in both domestic and foreign markets places a high priority on rising productivity, stable costs and prices, and the development of new and improved products. A critical factor in our balance of payments, in the years ahead, will be our trade surplus.

(*d*) Demand a larger participation of other advanced countries in the financial requirements of our common defense. The mission of Mr. Anderson and Mr. Dillon to West Germany in December was necessary and in pursuance of previous negotiation, and it is regrettable that it was misrepresented as an unsuccessful begging mission.

(*e*) Take steps to remove the tax incentives which are promoting private capital investment abroad in the industrially developed countries many of which, with our help, have regained their economic strength. Movements of private capital to and retention of earnings in such countries should now be left to the attractions of direct market advantage.

(*f*) Reduce the amount of foreign goods which returning tourists may bring into the United States free of duty, for reasons of equity if not for substantial savings.

(*g*) Continue the prohibition against the holding of gold abroad by nationals of the United States, recently announced by our Government and, perhaps, advance the effective date. The disruptive nature of whatever outflow of funds results from such purchases, and the patent inequities of prohibiting domestic gold hoards while permitting them abroad, warrants attempting to place all of our citizens on an even footing in this regard.

4. There are certain matters, other than the financial burdens of our common defense, which should be actively negotiated with foreign nations.

(*a*) Demands for or the need for foreign economic aid present themselves in a variety of forms having political, monetary, and economic implications, and they are without finite limit. There are three aspects of foreign economic aid to which we wish to call attention. First, the demand expresses itself in money terms but is in reality for men and materials, and there is more than waste involved if the moneys appropriated outbalance the availability of competent and devoted men. Second, it is past time for a significant redistribution of the shares of foreign economic aid provided by the various countries of the free world, whatever may be the aggregate size of the program, and this will require pressing forward vigorously on proposals which have been made for coordination of national programs in this area. Finally, along with such coordination, there should be an attempt to devise a means of scheduling foreign economic aid for more than a year at a time, if the constitutional processes of the several countries concerned can be adapted to permit it.

(b) The beginning which has been made by some foreign countries in anticipating repayment of long-term debts to the United States should be encouraged. The loans which we extended to help rebuild war-torn economies have served their purpose in the countries of many of the debtors, who may now be able to anticipate repayment of these loans, thus making them serve another useful purpose in behalf of the creditor and of international balance.

(c) With the restoration of currency convertibility in the principal money markets and the greater fluidity of capital in the world, the need for closer relations and more frequent consultation between financial authorities in these markets has become apparent. In addition to the governments involved, and the International Monetary Fund, the central banks of these countries, by periodic consultation and otherwise, could provide an important means of extracting mutual benefit from their separate financial policies, and should be entrusted with this task of quiet negotiation.

If the things we have suggested are said and done, we have no doubt that the balance of payments position of the United States will respond favorably and perhaps vigorously and fairly quickly.

There will still be unresolved, of course, the questions of whether, under present monetary arrangements, the need for international liquidity will increase and whether this will require the further piling up of foreign short-term dollar balances in excessive amounts. That is a problem which must be confronted eventually, but our immediate task is to remedy the current imbalance in our international accounts, so that the confrontation will not take place in an atmosphere of crisis and dollar weakness.

Domestic economic policy

The task of domestic economic policy for the year ahead will be unusually complex. It must contribute to a vigorous, sustainable domestic recovery and expansion, but it must be carried out at a time when actions will also be needed to strengthen our balance of payments position. Both are essential. We cannot rest content if equilibrium in our balance of payments is achieved only by maintaining excessive unemployment. On the other hand, actions designed to force domestic expansion without regard to our external transactions would be equally unwise. They would almost certainly seriously weaken international confidence in the dollar, and they would create inflationary pressures and inflationary fears, even though the process would start with unemployed resources. It is within this framework that we make our specific suggestions.

1. *Fiscal policy.*—The current disequilibrium in our balance of payments highlights the need for more reliance on fiscal or budget policy and less on monetary policy. If more stimulus is needed, it should come heavily from the budget side instead of through such measures of credit policy as would activate another outflow of short-term funds to other countries. It is, however, important that this shift in emphasis be undertaken in a way which demonstrates that the Government intends to pursue a firm budget policy.

(a) Accordingly, even in a recession the Government should continue to make its decisions about expenditure programs on the basis of the ongoing needs of the Nation for public services and facilities. It should not try to step up Federal spending, which does not meet this test, in order to counter the recession. Countering a mild and short recession by emergency public spending does not work well in practice. With even minimal lags most of the actual increase in spending will come after it is no longer appropriate. Moreover, such emergency spending programs would, in practice, establish a needlessly higher expenditure plateau from which the next increase would occur.

While a general tendency toward substantially enlarged spending programs is not needed or desirable, one area of particular needs does exist. The ultimate casualties of a recession are those who lose their jobs and are unable to regain employment before their unemployment compensation benefits are exhausted. It also seems clear to us that our present unemployment compensation program is not designed to deal with the substantial problem of unemployment arising out of major permanent reductions in job opportunities in an area or industry. Dealing with these problems in a prudent and effective manner is called for by humanitarian considerations, and it will also enhance the vitality of the economy both immediately and in the longer run. We have neither the space here nor the competence to lay out a program for dealing with these matters, but they deserve high priority at this time.

(*b*) Greater use of fiscal policy must be gained in general, however, through the receipts side of the budget. The basic revenue structure should be strong enough comfortably to cover outlays, so that deficits will ordinarily occur only in recessions, when a lessened tax burden is desirable and the danger of tripping off fears about inflation is at a minimum.

To meet the challenge of further action, if and when it is needed, we would join those who have recommended that the President be given discretionary authority to put into effect, for a statutorily limited period, some reduction in tax rates. Such action could exert an immediate effect on the economy, and it would not create a bias toward undesirable permanent increases in public spending. Moreover, the timing of a recession may be such as to make action desirable when the Congress is not in session—as has been true in our recent experience. The temporary reduction should be of limited amount, of relatively simple structure, and as "neutral" as possible in its impact on different groups.

(*c*) Some changes in our tax laws that would be helpful in promoting a vigorously expanding economy should be considered now, without waiting for a complete overhaul of the tax structure. As the economy is thereby strengthened any lost revenue would be recouped through a higher national income.

We believe these measures would considerably augment the practicabiilty of utilizing fiscal policy more actively in stabilizing the economy. At the same time the basic budget position would be under firm control—with expenditure programs determined by intrinsic need and desirability, and with a basic tax structure that would always cover these expenditures at reasonably full utilization of our productive resources.

2. *Monetary policy*.—It is our opinion that the Federal Reserve System has timed its changes in policy expertly in this recession. Early last year, before the onset of the recession was generally anticipated, action was begun to ease the reserve position of the banks. As signs of recession became clearer, further steps were taken to provide the banks with substantial "free reserves", and to make it possible for them to meet rising loan demands and to add to their investments, thus increasing the money supply.

There are modifications of technique in monetary policy, however, which we think might be useful in some or all circumstances. The first relates to changes in direction of policy. We cannot be sure, of course, but we can surmise that there may have been a tendency in times past for the System to concentrate largely on major moves from restraint to ease or ease to restraint, related to definite turning points in the economic situation. Because of the haziness which always surrounds the timing of such turning points, except on historical charts, our suggestion is that a sensitive and flexible approach might be to test the strength of cyclical movements of business, from time to time, with a recognizable change in reserve availabilities, which could be reversed if it proved to be premature.

Our second suggestion relates to policies which have been followed, which have related Federal Reserve open market operations solely to the provision of bank reserves and foresworn action to influence, directly, any part of the interest rate structure except at the short end of the range or rates. This has a particular relevance at a time when it is necessary to pay special attention to the spread between short-term interest rates in this country and in foreign money centers. It is there that action to provide bank reserves through purchases of short-term securities may magnify declines in money market rates of interest and provide an undesirable incentive for short-term funds to move abroad.

The defects of the policy, furthermore, are not confined to this special situation. There are occasions for attempting to exert some influence directly on long-term rates of interest by way of open market operations of the Federal Reserve System. This is the area where encouragement of or restraint upon investment takes place and if, at times, long-term rates are sticky, action could be taken to free them to move. Such intervention would not lessen the breadth of the market nor deprive it of its ability to reflect underlying factors of capital demand and savings supply. Neither would it nor should it involve pegging of rates nor attempts to prescribe a whole pattern of rates extending throughout the rate structure. But it would mean nudging a sticky market in the direction indicated by the underlying factors in the market, and thus contribute to the effectiveness of monetary policy.

There is one other matter we think is worth mentioning under the heading of monetary policy, and that is the statute which requires the Federal Reserve System to fix maximum rates of interest which can be paid by member banks on time and savings deposits. We believe that if such a regulatory power was ever needed, the time has passed for its use and that the fixed ceiling on such interest rates, at times, has been a factor in causing deposits to be taken out of banks in this country and sent abroad, particularly since the regulation does not apply to foreign branches of American banks. We would favor repeal of the statute.

3. *Debt management policy.*—While decisions about types and terms of securities issued by the Treasury do not constitute a major means of influencing economic activity, the difference between good policies and poor policies is an important one. The greater flexibility of recent years in methods of issuing and redeeming securities has been helpful, and further new approaches should be sought. To minimize interference with the effective conduct of monetary policy, it is desirable for the Treasury to strive continuously to reduce the frequency of its trips to the market. Finally, in the interplay of our domestic situation and our balance-of-payments position there is need for a fine adjustment between the requirements of the debt structure and of interest rate differentials between our money market and money markets abroad. There is no one right maturity structure, and there seldom seems to be an ideal time to market longer term issues, but an excessive piling up of the debt in short-term securities, by positive action or the passage of time, must be avoided. Within the limits of this imperative, appropriate financing in the short market would help to keep interest rates here from sagging below money market rates in foreign money centers.

Two changes would, we believe, be helpful in managing the debt. The ceiling of 4¼ percent on issues with a maturity of over 5 years should be eliminated. Its effect is at times to produce serious distortions in the conduct of debt management operations. Second, the debt ceiling should also be eliminated. In practice it is apt to be either ineffective or mischievous. If the ceiling is far above the debt outstanding, it has no influence. If it is close enough to be a potential constraint, a shortfall of revenue, induced by a recession, forces the Government into measures that aggravate the recession.

4. *Price and cost policies.*—There are substantial differences of opinion about the extent of probable inflationary pressures, or the extent of the damage to our economy that would occur if we did have some chronic inflation. We believe that the capacity of the economy to tolerate inflation is at least considerably reduced now, both for domestic and international reasons. Accordingly, the time is ripe, in addition to the basic requirements of good monetary and fiscal policy, to take some other steps that would be helpful in preventing inflation.

First, as a Government and as a nation we need to give more explicit attention to the subject of improving productivity. If the rate of gain in productivity could be stepped up, we could lift levels of living more rapidly at home; and lower pressures on costs would improve our competitive position abroad. Stepping up the rate of gain in productivity will be difficult; and some developments will make for a lower rate of gain in the years ahead. More younger workers will be in the work force. We have about exhausted the rapid increase made possible in our earlier history by a shift from agricultural to industrial work. And, the demand for services is apt to continue to grow more rapidly than the demand for industrial products.

We believe, therefore, that the objective of enhancing the capacity of the economy to improve productivity should be high on the national agenda both at the research and at the operational level. Ways of accelerating the use of better and more productive machinery and equipment must be sought. We shall need to upgrade the skill-level of the labor force. Research has shown that new and complex management systems, eliciting the strong cooperation and involvement of employees in finding and implementing ways of doing things better, have established the basis for achieving significant gains in productivity. This country's heritage of a democratic, classless society puts it in a peculiarly strong position to tap the full creative powers of all our people.

Second, we must strengthen the conditions essential for vigorous price and product competition. It is the relentless pressure of competition that fuels the drive for new and better things, and gets these fruits of progress promptly disseminated to the whole people. Moreover, few things do more to encourage price flexibility and product innovation than knowledge that an aggressive competitor would otherwise take over. There is clear evidence that consumers respond actively to the price factor and to products that are new and better as well as different.

Third, we believe that a part of our difficulty in maintaining a stable price level has arisen because our wagemaking arrangements have tended to produce wage settlements averaging, for the whole economy, more than the general increase in productivity, even in the absence of an inflationary volume of demand. There are now some hopeful signs. A wider understanding exists of the simple fact that persistent increases in unit production costs mean a rising price level, or enlarged unemployment, or some combination of the two. The recedence of inflation mindedness has created a more favorable environment within which wage negotiations can take place. Greater awareness of foreign competition, actual and potential, has had a restraining influence. Something more might be gained from quiet explorations by management and labor of the interrelated subjects of productivity, costs, and prices without the publicity and pressure of a wage contract deadline. Perhaps more collective consideration would improve the results of collective bargaining.

Whether these trends toward moderation will prove to be adequate remains to be seen. Formalized proposals calling for governmental machinery to pass upon wage and price decisions in major industries impress us as creating more problems than they would solve, and could well exert an upward bias on price decisions. At this juncture we believe the administration would be wise to avoid a doctrinaire approach, to watch developments closely as the next expansion unfolds, and to rely on the considerable power of restraint inherent in public opinion.

Fourth, section 2 of the Employment Act of 1946 should be amended to include reasonable stability of the general price level as one objective of national economic policy. Clearly, it is one of our objectives, and our declaration of national economic policy should include it. This would stiffen our own national will to achieve the greater stability of our price-cost level that would make possible a more orderly, vigorous, and sustained pace of economic growth. And it would be an explicit declaration to the free world that the dollar is to be maintained as a strong currency of stable value.

CONCLUSION

In assembling our views for you we have concentrated our attention on the immediate, interrelated and critical problems of countering economic recession at home and strengthening confidence in the dollar abroad.

We have made suggestions for actions and policies which we think will help to correct these weaknesses. We believe that correction will come quickly if right and resolute action is taken.

We hope that what we have written will contribute to that end.

ROY BLOUGH,
PAUL W. MCCRACKEN,
ALLAN SPROUL, *Chairman*.

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