REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

MONDAY, AUGUST 14, 1961

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

The joint committee met, pursuant to notice, at 10 a.m., in room G-308, New Senate Office Building, Hon. Wright Patman (chairman) presiding.

Present: Senators Douglas (cochairman), Proxmire, Pell, and Bush; Representatives Patman (chairman) presiding, Reuss, Griffiths, Curtis, and Widnall.

Also present: William Summers Johnson, executive director, and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN. The committee will please come to order.

The committee begins hearings this morning on the "Report of the Commission on Money and Credit"—or at least on those aspects of the report which are most relevant to the committee's jurisdiction.

We already know that the report is a lengthy document, some 282 pages, covering a wide range of subject matter and containing more than 85 specific recommendations. Obviously, we cannot, in the course of hearings, go into all of these recommendations and give them the attention they deserve.

The committee's primary interest is, of course, with those recommendations most related to the committee's duties as set out in the Employment Act of 1946. This act declares that it shall be the responsibility of the Federal Government—

* * * to coordinate and utilize all of its plans, functions, and resources * * *.

for the purposes specified in the act. These purposes are, in the main—

* * * to promote maximum employment, production, and purchasing power * * *.

Accordingly, the committee will be mainly interested in questions of coordination and utilization of the Federal Government's plans, functions, and resources toward achievement of the objectives of the Employment Act.

It appears that the Commission's report contains many recommendations which are concerned primarily with questions of equity as between competing groups of financial institutions. To the extent possible, we will try to avoid consideration of these issues, not only because they are questions which can better be taken up by the legislative committees of Congress, but because our preliminary inquiries have indicated some of the private groups having a direct interest in

these questions are not yet ready to be heard. To avoid the possibility of seeming to be unfair, it is better that we do not hear one side to these controversies until such time as all sides can be heard.

A full investigation and study of the Nation's money and credit system is a matter of the greatest public importance, and one which is long overdue—or at least it has seemed so to me.

In 1908, the Congress set up a National Monetary Commission, popularly known as the Aldrich Commission, composed of nine members of the Senate and nine members of the House, to make an investigation of the Nation's money and credit system. And again in 1912, the House of Representatives adopted a resolution instructing its Committee on Banking and Currency to make an investigation to determine whether there was an undue concentration of financial or banking power in the United States. This was known as the Pujo Committee, whose counsel was the late Samuel Untermeyer. The investigations and reports of these two famous congressional committees brought about important reforms in our money and banking system, and are sometimes credited with having brought about the establishment of the Federal Reserve System.

But in the approximately half century since these famous investigations were made, a great many changes have taken place in our economic system, in our financial institutions, and, some of us hope, in the arts and sciences of government and economics.

Because many people, including myself, believed that the time had come when Congress should again make an investigation and study of the money and credit system, I introduced in 1955, in the 84th Congress, House Resolution 210, to provide for the appointment of a committee of the House to make such a study. At that time the proposal was very hotly contested. There was wide public concern with what was then a tighter money monetary policy and a higher level of interest rates than the public had been accustomed to for many years past. On the other hand, leaders of the congressional opposition to the resolution argued that the economy was running fine and that to make a study of the money and credit system would be like taking the back off a fine watch and tinkering with its mechanism.

We succeeded, nonetheless, in getting the resolution through the House Rules Committee, and to a vote in the House, in June of 1955. The resolution failed to carry, however, by a vote of 214 to 178.

During the next year, 1956, the monetary authorities progressively tightened money, with the result there was even wider public concern and some claims of hardship and distress—such as from the housing industry.

It was my task to be chairman, at that time, of a subcommittee of this committee; and in December 1956, shortly before the new Congress was to convene, we held extensive hearings, here in Washington, on the state of the economy and the effects of the monetary policies being pursued at that time.

These hearings did not dispel the belief that an investigation and study of the whole money and credit system was badly needed.

Accordingly, on the opening day of the new Congress, on January 7, 1957, I introduced House Resolution 85, to authorize the House Committee on Banking and Currency to make an investigation and study of the money and credit system.

A few days later, on January 10, President Eisenhower sent down his state of the Union message, stating that he felt the time had come to "conduct a broad national inquiry into the nature, performance, and adequacy of our financial system * * *" and asking for congressional authority to appoint a commission of "able and qualified citizens to undertake this vital inquiry."

On that resolution, Mr. Wilde, our witness this morning and who is head of this famous commission, testified at one of the rare occasions when a person outside of the Congress has testified before the Rules Committee.

Very few times since I have been in Congress has an outsider been allowed to testify before the committee, but, because of his knowledge of the subject, Mr. Wilde appeared on February 28, 1957, before the House Rules Committee in opposition to House Resolution 85 which I had introduced for the purpose of authorizing the House Committee on Banking and Currency to conduct such an investigation.

At that time Mr. Wilde favored a private commission, to consist of both private citizens and Members of Congress. Specifically he said that the proposed CED

> Commission on National Monetary and Financial Policy should include some Members of Congress and some private citizens. The case for including Members of Congress is simply that there are some exceedingly well-qualified men in each House and that their participation would increase the acceptance of the study's findings in the Congress and in the country.

Later in his testimony he again emphasized this view during an exchange with Representative Thornberry:

> Mr. THORNBERRY. But you don't think that Congress, which in the end is responsible to the people of the country, through a recognized committee, ought to make the study?
>
> Mr. WILDE. Yes; I do. I think the Congress should make the study in combination with a business group. I think it should be a mixed commission * * * [1]

In fact, Mr. Wilde even gave an estimate as to the number of persons, including Congressmen, that should be on the "mixed" commission. He felt that 8 to 10 private citizens would be sufficient to represent adequately the various sectors in the economy, and that an additional "6, 8, or 10" could be taken from the two Houses of Congress.

On January 14, the ranking minority members of the Committee on Banking and Currency of both House and Senate introduced identical bills authorizing the President to appoint such a commission of private citizens to undertake the study. Those bills were criticized on several grounds, including which was the argument that the President needed no legislative authority to appoint a commission of private citizens to make a study of anything, as indeed he had appointed many other private commissions to study other matters.

On January 24, the ranking minority member of the House Committee on Banking and Currency (Mr. Talle) introduced H.R. 3660 which set forth an amended proposal. This called for the appointment of a Commission, nine of whom were to be appointed by the President and an additional four to be drawn from Members of Congress. These four were to be the ranking majority and minority members of the two committees on Banking and Currency.

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[1] Source: Congressional Record, appendix, September 19, 1957, pp. 7527, 7529, 7530 (insertion of testimony before the House Rules Committee, as part of a statement offered by Mr. Patman).

We succeeded in having the Rules Committee report my resolution on March 20. However, a few days later, on March 25, Mr. Talle introduced H.R. 6332, which offered a somewhat larger congressional representation on the proposed Presidential Commission. This later bill provided for a Commission of 16 members, 8 of whom were to be appointed by the President, 4 to be appointed by the Speaker of the House, and 4 to be appointed by the President of the Senate, who was, of course, Vice President Nixon.

House Resolution 85 was debated and voted on in the House on March 27. This time the opposing argument was that a congressional investigation and study would conflict with President Eisenhower's request, and, further, that the group making the study should contain broader representation than just Members of the House of Representatives. House Resolution 85 failed by a vote of 225 to 174.

Some months later the announcement was made of the formation of the Commission on Money and Credit to make a study and investigation. I believe that this Commission is made up entirely of private citizens. Mr. Frazar Wilde is chairman of the Commission, and is here today to describe the origins, purposes, and operating methods of the Commission, as well as to give us an introduction to its report.

After Mr. Wilde's introduction, the general pattern of our agenda for the rest of the hearings is this:

Members of the Commission on Money and Credit will present the Commission's views and recommendations on particular topics. Following these presentations we have invited distinguished former officials and outstanding experts in the academic fields to comment on these specific items. One topic to be omitted is that dealing with international monetary policies, the reason being that our Subcommittee on International Exchange and Payments is just completing an intensive study of this subject.

Mr. Wilde, we are glad to have you, and you may be sure that the committee will be most attentive and interested in the conclusions and recommendations which your distinguished Commission has reached.

I personally feel—and I know that I express the views of the members of the committee in this—without respect to the content of its recommendations, that the Commission on Money and Credit has done an important public service in bringing to public attention the problems dealt with in your report.

Since the ranking member of our committee, Senator Prescott Bush, of Connecticut, is from the State where Mr. Wilde resides, I feel that it is appropriate to call on Senator Bush to present Mr. Wilde.

Senator Bush. Thank you, Mr. Chairman.

I consider it as a very high privilege, indeed, and I am very grateful to you for that courtesy.

I have known Frazar Wilde for many years. He is, as you suggest, one of the very outstanding citizens of the State of Connecticut, and one who has rendered many services to his community and to his Government, all on a pro bono publico basis.

He is chairman of one of our great insurance companies in the State that is known as the Insurance State. He has for many years been an occasional consultant to the Secretaries of the Treasury and other officers of the Department of the Treasury. And his most recent contribution, as you have said, is his chairmanship of this special Com-

mission that has been created by the CED and financed by the Ford Foundation in the interests of improving public understanding in connection with matters affecting money and credit and making suggestions to the Congress of legislation which might be appropriate in that field.

His job has been a very difficult one. There are 27 members of the Commission, rather than the 8 to 10 which he thought might originally be a pretty good-sized Commission. When you get a Commission of "all stars" from all over the United States, it is a pretty difficult group to preside over. But it appears from the report and from informal reports that we have received from members of the Commission that Mr. Wilde has done an amazing job presiding over this group of stars, and he has produced a report which has caused widespread comment and a great deal of favorable comment throughout the United States.

So I take very great pleasure in presenting Mr. Wilde to the committee today, and I thank the chairman again for the privilege of doing so.

Chairman PATMAN. Mr. Wilde, you may proceed in your own way, sir.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN OF THE COMMISSION ON MONEY AND CREDIT; ACCOMPANIED BY BERTRAND FOX, RESEARCH DIRECTOR, EDSEL BRYANT FORD PROFESSOR OF BUSINESS ADMINISTRATION AND DIRECTOR OF RESEARCH, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, HARVARD UNIVERSITY

Mr. WILDE. Mr. Chairman, Senator Bush, I appreciate your kind introduction very much.

I am not that good, but this effort has been very stimulating, very challenging, and I hope it has and will make a contribution to the country's understanding of our financial apparatus.

I am Frazar B. Wilde, Hartford, Conn. (chairman of the board of the Connecticut General Life Insurance Co.). I am appearing here today as Chairman of the Commission on Money and Credit. As such I welcome your invitation to present to the Joint Economic Committee of the Congress the report of the commission.

First, I should like to present a brief history of the Commission, which has spent much of the last 3 years preparing this document.

Then I should like to set forth what I believe to be the philosophy underlying the conclusions arrived at by a majority of its members.

And finally I should like to relate this philosophy to these conclusions as a guideline to why the Commission has made its various proposals for improving the economic health of the private enterprise system under our democratic form of government.

Congress, and especially the Joint Economic Committee since passage of the Employment Act of 1946, has made many outstanding studies of various aspects of fiscal, monetary, and debt management policy and their relationship to economic growth, stable prices, and high employment. But there had been no overall study of money and credit, in all of its components, made by any one group in the half century that passed since the report to Congress of the Aldrich Commission, out of which came the Federal Reserve System.

For several years many individuals and groups, of which the Committee for Economic Development was among the first, had urged such a comprehensive study, especially since it had become apparent how vastly our financial system had grown and changed since the establishment of the Federal Reserve System in 1913.

It became apparent in 1957, after President Eisenhower had suggested a monetary commission, that Congress and the Executive could not agree upon a formula for conducting such a survey under Federal auspices. At this time the nonpartisan Committee for Economic Development undertook the creation of a wholly independent and objective private organization. This group of 25 citizens was then charged with making a realistic and comprehensive survey of all public and private U.S. financial and monetary institutions and with recommending what changes, if any, were necessary to revitalize and improve them, under present conditions, so that they might meet the exacting challenges of the next decade.

The funds to support this undertaking were obtained from the Ford Foundation and to a lesser extent from the Merrill Foundation and the Committee for Economic Development. A group of distinguished social scientists selected the membership of the Commission, which was to be broadly representative of the various economic and social sectors of American life. (The full membership of the selection committee, the Commission on Money and Credit, and its staff and advisers, are published hereafter in these hearings at pages 12–13.)

At the very moment the Commission was being set up, the Joint Economic Committee was beginning its studies of employment, growth, and price levels. The hearings, special studies, and reports contributed considerably to the work of this Commission, supplying much needed documentation and data that it would have taken this private Commission years to assemble. Nevertheless, a vast body of additional research was undertaken by the Commission.

Leading scholars in U.S. universities were called upon for their wisdom. A competent staff correlated their findings. The report itself, however, in its final form represents the findings and suggestions of the members of the Commission. All members approved the major substance of the report. Because of their diverse backgrounds and interests the result is, I am certain, a consensus of economic judgment as it exists today in America. This, I think, increases the value of the report, which represents no partisan point of view. Equally important is the fact that many individual members of the Commission have stated their dissents as footnotes where they have disagreed with the majority view as expressed in the document.

In approaching its task the Commission worked on the principle that in the American society the status of the individual must be of paramount concern. Our political and economic systems were founded on this tenet and have been developed along these lines since 1789.

Throughout history the private economy has accounted for the overwhelming bulk of our national production. The direction and distribution of this production has always been guided by the decisions of a huge number of individuals coordinated in the marketplace. It should hardly have to be reiterated at this late date that the dynamics and growth of the American economy have stemmed from the incentives, ingenuity, and skills of countless individuals.

The whole purpose of the Commission's recommendations has been directed toward preserving and strengthening this tradition.

The national economic goals, to the attainment of which the report is addressed, lie closely within this concept of our society. These goals in essence are low levels of unemployment, sustainable growth, and reasonable price stability. By attaining these, the individuals who make up our democratic society can prosper and the Nation can continue to grow.

The role of government in our society is primarily to make possible and to preserve opportunities for the individual. This is the large, important, and necessary role of government. There are many functions of society which, by general agreement, cannot be left in private hands but must be given to the government of the people to perform. The proper performance of them will provide the right climate within which individuals may better realize those indestructible and final goals of the United States—"life, liberty, and the pursuit of happiness."

Under this concept the proper actions of government cannot be an encroachment upon the essential liberties of individuals. When intelligently and purposefully discharged they place government not above the individual but as his partner. In any advanced society government must not only "coin" but control the supply of money. It must spend money for the general welfare. And it must levy taxes to support the collective desires of the people.

The Constitution of the United States gives to the Federal Government, among other essential rights, this control over the money and credit of the United States. To the Commission this means that the Federal Government is charged with regulating the money so as to provide the private economy with the best possible opportunity to contribute to the attainment of all national goals—including growth, high employment, and price stability.

Through this great power the Government can make important, indeed indispensable, contributions to the climate within which our private economy operates. Those who value this private economy—what we call the free enterprise system—must place themselves on the side of progress in the use of these powers, otherwise those who would distort the appropriate functions of Government will hold sway.

The recommendations of the Commission are directed toward the better use of existing powers and they are related coherently to the attainment of these goals. They are a direct outgrowth of this philosophy which I have expressed. Recognition of this, I feel free to say, was in the minds of all members of the Commission, whether or not they dissented from particular recommendations. Within this philosophy there is ample room for well-meaning and well-informed men to differ in their judgment concerning the role of the individual or of government. There is also room for consensus and unanimity, in spite of the vast and complex system of money and credit which is the major subject of this report.

By the very nature of the task assigned to it the report of the Commission is lengthy and, perhaps, diffuse. It contains more than 85 specific recommendations. These are in the realm of monetary policy, fiscal policy, debt management, the private financial sector, Federal credit agencies, international economic relations, and governmental organizations stemming from them. It covers wider ground than did

the Aldrich Commission report, to which it has frequently been compared, mainly because of the growth of financial institutions and the changes that have taken place in their functions and the economy since then.

I shall not discuss them all here in this introduction nor should it be considered that those sections which I do discuss are the only elements of high priority contained in the report.

In its lengthy studies the Commission dealt with money and credit in a broad context. It considered money and credit together as a major factor contributing to the attainment of the national objectives of economic growth, low levels of unemployment, and reasonable stability of the price level. The Commission considered money and credit within the framework of these objectives. Therefore it assigned priority to no single one of them. It was well aware that many other factors have a large role to play. Although it examined these, it did not feel that it was within the scope of its assigned task to develop them with any degree of completeness.

The Commission, for example, was well aware that the tax structure—at Federal, State, and local levels—exerts a major influence on the attainment of the three objectives, and particularly upon economic growth. This assumption is stated in the report. But reform of the basic structure of the American tax system was beyond its terms of reference. It is the subject of continuing scrutiny in other quarters.

However, it could not ignore the role which taxation plays in forming national policy aimed at stabilizing the economy. The Commission considered what it believes to be the excessive progression of the basic tax structure and it did point out the serious need for a review of the basic tax structure from time to time.

The Commission did develop a specific plan, which is fully explained in the report, for changes in the tax rate which the Commission felt necessary under designated circumstances, to facilitate national countercyclical policies. The Commission's plan has some degree of novelty in that, when looked as superficially, it seems to usurp the power of Congress to levy taxes. This is not the case, as an examination of the proposal reveals. It is an extension of congressional power to be used by the President only in times of economic stress, and is subject to congressional veto.

This evolutionary, rather than revolutionary, idea has been criticized as giving the President too much power. In similar fashion the Commission's recommendations concerning the Federal Reserve System have been challenged for robbing the System of its historic independence. This, I feel, is due to a misreading or to a misunderstanding of what the Commission had in mind, and to a reading of one or two important suggestions out of context. The changes in the System which the Commission recommends should be weighed as a whole, otherwise the Commission's objectives in making these recommendations will be missed.

The Commission, it seems to me, is well aware of the necessity of retaining for the Federal Reserve a position of independence from which it can continue to advance monetary stability while resisting encroachment from the Treasury. The Commission begins its argument by stating that the Governors of the Federal Reserve should be men of great competence, ability, and objectivity. In order to

obtain such men the Commission recommends a reduction in the number of Governors from seven to five and it would pay them the highest possible salaries available to appointive offices in the Federal Government. It is easier to get five men to serve than seven. It is easier to get highly qualified men if the salary range is in keeping with current standards for the level of responsibility they carry.

From such a competent group the Commission recommends that the President appoint a Chairman for a term coterminous with his own term of office.

This proposal has been criticized as a politically inspired device which would "rob" the Federal Reserve of its independence.

Before passing judgment on this proposal it should be noted that the Commission also recommends that each member of the Board of Governors should have a 10-year term. Since the Chairman must be appointed from among these five members, the charge that the Chairman would be "subservient to the President" is destroyed. It is too often forgotten that both the Federal Reserve System and its Board of Governors are basically responsible only to the Congress. At the same time it should be remembered that the Board, and through it the System, does not operate in a vacuum. It is a vital partner of whatever administration is in power. As such a partner it must (and it does) contribute to the national economic objectives. But these, in the final analysis, must be originated, developed, and executed by the administration. Thus the Commission's recommendations for these changes are realistic. They preserve and they strengthen the independence and usefulness of the Federal Reserve.

Many critics of this proposal either forget, or have never known, that both the present Chairman of the Federal Reserve Board and his predecessor (Mr. Martin and Mr. McCabe) have testified in behalf of a term for the Chairman that runs coterminously with that of the President, and that this probably was the intent of the Congress when the present 4-year term was written into the act.

Another important decision made by the Commission is its judgment on the so-called numbers game. The Commission wisely concluded that it would be a mistake to make recommendations with rigid formulas and precise figures. The report points out that "statistics measure what is and has been" but that public policy "must prescribe what ought to be." Statistics are guides, and useful as such. The Commission does not expect to see the day when human wisdom in public affairs can be dispensed with in favor of figures alone.

This seems to be especially true with respect to a target figure for national economic growth. Any growth figure is difficult to defend. If adopted, any arbitrary figure would seldom, if ever, work out on a 1- or 2-year basis. The setting of such a target figure would not be understood. It might well result in a continuous, futile debate. Moreover, such a figure would be compared with the growth rates of other countries, which have a different statistical concept than ours. The United States, in my opinion, would be subject to invidious comparison and to a loss of self-confidence.

Instead of setting any statistical goal, the Commission believes it is a better rule to state objectives broadly, to fix the responsibilities sharply, and to make available through statutory authorization a variety of means for their discharge. It believes that in the fuller

observation of that rule lie opportunities for better executive coordination and improved cooperation between Congress and the Executive for the furtherance of national goals.

Another vital element of the report is its discussion of inflation. The Commission strongly believes that there is no need to accept inflation as a way of life in this country. Quite the contrary, the report points out that inflation is a serious enemy of real and sustained progress. It shows clearly, I think, that price stability is compatible with growth and high employment and that it can, indeed, make a solid contribution to the attainment of both.

One of the most important and exacting tasks facing the Commission was its examination of the nation's private financial institutions. The Commission took a broad view of this sector of the economy. It looked for ways to increase the opportunity of all people for deposit and savings and it sought ways to increase the resources of, and competition among, lenders. It felt that all potential borrowers, no matter what their particular credit needs might be, should have access to more sources of funds. Only by moving freely in this direction, the Commission felt, can the private financial system meet its major obligation of contributing most fully to growth, employment and stability.

Specific recommendations in this section of the report call for more freedom for bank branching in trading areas, for the Federal chartering of savings banks, for tax equality among financial institutions, and for liberalizing the rules covering investment. These all follow from the basic premise just stated.

The Commission explored the importance of near-moneys and money substitutes as factors in influencing the attainment of our economic objectives. Recognition of the relevance of these factors played a role in the Commission's views on the "bills only" policy of the Federal Reserve and on Treasury debt management. It was a major consideration in forming its views on the regulation of nonbank financial institutions.

A distinction should be drawn between recognition of the important influence of money substitutes and appropriate measures to deal with this problem. From the evidence available to it the Commission concluded that additional direct controls over nonbank financial institutions are not needed. This, I want to point out, was not a casual conclusion.

At the same time the Commission did find that Government credit agencies require more coordination and liaison than currently exists.

Another significant section of the report deals with the controversial problem of the use of direct controls over money and credit. Some observers of the economic scene have felt that the economic fluctuations which continue to beset us could be mitigated by the use of specific selective controls. Those most commonly recommended are in the area of consumers' durable goods, particularly automobiles. Other controls that have been seriously considered and recommended in some quarters are inventory control and control of plant and equipment expenditures.

The Commission was divided on the subject of consumer controls and there was little support among its members for control of plant and equipment or inventory. It did, however, make recommendations for conscious and rational control in the housing field.

The Commission in its report makes it clear that monetary policy alone should not be asked to carry the full burden required to attain the national objectives of growth, high employment, and price stability. Other Government programs, notably fiscal policy, but also debt management policy, are required to add their weight.

The report does not say that the Government should rapidly and substantially increase its participation in the Nation's business. The national product today is roughly divided between 20 percent in the Government sector and 80 percent in the private sector. Obviously, encouragement to the private sector is the overwhelming need. The task of Government is not to increase its share in the national product but to rationalize it so that it is even more effective in its complementary relationship to the private area.

Throughout the report the Commission is aware of the towering role which the President must play in our democratic form of government. The Commission is well aware of the fact that the job the President is asked to do is almost overwhelming by the very nature of the office. No President can avoid the responsibility of furthering the national objectives. Throughout most of our history the problems have been mostly domestic ones. But in recent decades wars, whether hot or cold, have been our continuous lot. Thus the load upon the President has been nearly doubled. The recommendations in this report affecting the President would, in the Commission's opinion, aid him in carrying this double load. They are based upon the sound theory of building upon the present structure rather than introducing news groups.

In concluding this brief introduction to "Money and Credit," the report of the Commission, I would like to quote these pertinent passages:

> The Federal Government must have a set of policies with respect to the level and composition of its expenditures, the structure of tax rates and composition of the debt, and terms on which it grants, insures, or guarantees loans, and the size of the money supply. And clearly it makes a difference what these policies are.
>
> Because they influence our economy in so many important ways, it is essential that Federal policies on expenditures, taxation, debt management, and credit terms should be explicitly chosen in such a way as to foster the achievement of sustained high employment, reasonable price stability, and an adequate rate of growth. Those goals cannot be achieved by the private enterprise system alone or by the Federal Government alone; but we are not likely to achieve them unless monetary, fiscal, debt management, and credit policies are chosen with reference to their effect on the achievement of those goals. It is not appropriate to blame the Government for every defect in the performance of our economy. But when the economy's performance is not entirely satisfactory, it is appropriate to ask whether chanegs in Government policies can be made to improve its performance.

This, I think, sums up the philosophy underlying the report. However, I would like to urge that only a reading of the complete report, long as it is, will give the full flavor of its many recommendations.

Chairman PATMAN. Without objection, we will have 10 minutes each on the first go-around with the witness, and I will ask the deputy director and the clerk to keep the time and to notify me at the end of 10 minutes, if I use that much time in the beginning.

Your report lists the names of the selection committee, Mr. Wilde?

Mr. WILDE. Yes, sir.

Chairman PATMAN. I believe these should be in the record. Do you have them written for the record?

Mr. WILDE. Yes, I have.

Chairman PATMAN. Let us put them in, please.

(The list referred to is, as follows:)

SELECTION COMMITTEE

Robert D. Calkins, chairman; president, The Brookings Institution.
Arthur F. Burns, president, National Bureau of Economic Research, Inc.
Everett Needham Case, president, Colgate University.
Charles W. Cole, president, Amherst College.
Morris A. Copeland, professor of economics, Cornell University.
August Heckscher, director, The Twentieth Century Fund, Inc.
Pendleton Herring, president, Social Science Research Council.
J. E. Wallace Sterling, president, Stanford University.
H. Christian Sonne, chairman, National Planning Association.
Herman B. Wells, president, Indiana University.

Chairman PATMAN. Who selected this committee, Mr. Wilde?

Mr. WILDE. My recollection—I will have some of my associates check me—was that it was largely a very respected and very able citizen, Donald K. David, of the Ford Foundation, and chairman of CED.

Chairman PATMAN. He is the one that selected the committee?

Mr. WILDE. I think he did; the selection committee, not the members of this Commission.

Chairman PATMAN. He selected the selection committee?

Mr. WILDE. That is right.

Chairman PATMAN. And the selection committee selected the committee?

Mr. WILDE. That is right.

Chairman PATMAN. How many were on the selection committee?

Mr. WILDE. The selection committee had 10.

Chairman PATMAN. You will put them in the record, too, please, at this point, a roster of the Commission membership.

(The list referred to is, as follows:)

MEMBERSHIP OF COMMISSION

Frazar B. Wilde, Chairman; chairman, Connecticut General Life Insurance Co.
H. Christian Sonne, Vice Chairman, New York, N.Y.
Adolf A. Berle, Jr., New York, N.Y. (Withdrew to serve as chairman of the U.S. State Department Latin America Task Force.)
James B. Black, chairman of the board, Pacific Gas & Electric Co.
Joseph M. Dodge, chairman of the board, the Detroit Bank & Trust Co. (resigned October 7, 1960).
Marriner S. Eccles, chairman of the board, First Security Corp.
Lamar Fleming, Jr., chairman of the board, Anderson, Clayton & Co.
Henry H. Fowler, Fowler, Leva, Hawes & Symington. (Resigned February 3, 1961, on his appointment as Under Secretary of the Treasury.)
Gaylord A. Freeman, Jr., president, the First National Bank of Chicago (appointed April 29, 1960).
Fred T. Greene, president, Federal Home Loan Bank of Indianapolis (died March 17, 1961).
Philip M. Klutznick, Park Forrest, Ill. (Resigned February 8, 1961, on his appointment as U.S. representative to the Economic and Social Council of the United Nations.)
Fred Lazarus, Jr., chairman of the board, Federated Department Stores, Inc.
Isador Lubin, Arthur T. Vanderbilt professor of public affairs, Rutgers University.

J. Irwin Miller, chairman of the board, Cummins Engine Co.
Robert R. Nathan, Robert R. Nathan Associates, Inc.
Emil Rieve, president emeritus, Textile Workers of America, AFL-CIO (appointed May 19, 1960).
David Rockefeller, president, the Chase Manhattan Bank.
Beardsley Ruml, New York, N.Y. (died April 18, 1960).
Stanley H. Ruttenberg, director, Department of Research, AFL-CIO.
Charles Sawyer, Taft, Stettinius & Hollister.
William F. Schnitzler, secretary-treasurer, AFL-CIO (resigned April 28, 1960).
Earl B. Schwulst, president and chairman of the board, the Bowery Savings Bank.
Charles B. Shuman, president, American Farm Bureau Federation.
Jesse W. Tapp, chairman of the board, Bank of America, N.T. and S.A.
J. Cameron Thomson, retired chairman of the board, Northwest Bancorporation.
Willard L. Thorp, director, Merrill Center for Economics, Amherst College.
Theodore O. Yntema, chairman, finance committee, Ford Motor Co.

STAFF OF THE COMMISSION ON MONEY AND CREDIT

Bertrand Fox, research director,
Edsel Bryant Ford, professor of business administration and director of research, Graduate School of Business Administration, Harvard University.
Eli Shapiro, deputy research director, professor of finance, School of Industrial Management, Massachusetts Institute of Technology.

The following individuals served as members of the staff of the commission during varying periods of its existence:

Robert Z. Aliber
George K. Brinegar
Joseph W. Conard
John C. Dawson
James S. Duesenberry
William B. Fairley
Burton C. Hallowell
William F. Hellmuth
Robert F. Lenhart, executive secretary.
Porter McKeever, director of information.
Vivian C. Howard
David Kettler
Harvey C. Mansfield
Lawrence S. Ritter
Ira O. Scott, Jr.
William L. White
Mary C. Wing
Karl Schriftgiesser, assistant director of information.
Harry E. Rabey, comptroller.

Chairman PATMAN. And this selection committee selected the committee that you were talking about?

Mr. WILDE. That is right.

Chairman PATMAN. Did the selection committee select you as a member?

Mr. WILDE. As a member of this commission?

Chairman PATMAN. Yes, sir.

Mr. WILDE. Yes, they did.

Chairman PATMAN. Did they select you to be chairman of the commission?

Mr. WILDE. I wish I knew who did that to me. I do not know, Congressman. I found out that I was to be chairman. I assume that it met the democratic process of the members of the commission who had been selected by the selection committee.

Chairman PATMAN. How were the selections of the members made by the selection committee? In other words, were nominations made to the selection committee or did they make the nominations themselves?

Mr. WILDE. I really do not know, sir.

Chairman PATMAN. You do not know whether they decided by vote of the members or not?

Mr. WILDE. No, I do not.

Chairman PATMAN. And I guess Mr. David would be the one to ask about that, would he not?

Mr. WILDE. Or Mr. Robert D. Calkins, chairman and president of the Brookings Institution, who was chairman of the selection committee.

Chairman PATMAN. We will ask him for further information.

Do you know how the staff of the CMC Committee was selected, who selected them?

Mr. WILDE. The staff?

Chairman PATMAN. Of the Committee on Money and Credit, how the staff was selected. Who selected them?

Mr. WILDE. We selected them by, you might say, trial and error in order to find out which of several distinguished scholars could be available to undertake this work, and, as I remember it, several members of the commission and Mr. Donald K. David. I was in that act, but I am not certain of all the people that participated.

Chairman PATMAN. Did you change the staff members from time to time, let some out and bring more in?

Mr. WILDE. Subordinate staff. The two chiefs of staff, Mr. Bertrand Fox and Mr. Eli Shapiro, were continuously there, but scholars who were assistants to them did change.

Chairman PATMAN. How were the work assignments and task force assignments of the members made?

Mr. WILDE. They were made by the chief of staff and assistant chief of staff based on their knowledge of the scholars they were hiring and what part of the work they would be most competent to help in.

Chairman PATMAN. Who selected the people who wrote the paper for you?

Mr. WILDE. Who wrote the Commission report or these scholars' reports?

Chairman PATMAN. The scholars' reports, I assume.

Mr. WILDE. That was the background material.

Chairman PATMAN. Yes, sir.

Mr. WILDE. Those were selected pretty much by Dr. Fox and Dr. Shapiro.

Chairman PATMAN. How many papers and reports did you receive?

Mr. WILDE. Mr. Chairman, could I ask my associates? I know there was a tremendous——

Chairman PATMAN. I wish you would, please. Do you have an associate here? Have him come around.

Mr. WILDE. Could I ask Dr. Fox to come up.

Chairman PATMAN. I assume you have the correct number. If you do not, the approximate number. How many technical papers were prepared?

Mr. WILDE. About 110 to 120, Dr. Fox said.

Chairman PATMAN. Did you read all these papers? I assume you would not have the time to read all of them.

Mr. WILDE. No, we had all of these papers read by the staff, not the people who did the papers, but the people like Dr. Fox and Dr. Shapiro and others, and the conclusions were reported to the Commission at its meetings, what these different people had thought about different aspects of this financial study.

Chairman PATMAN. In other words, the staff briefed you?

Mr. WILDE. Yes.

Chairman PATMAN. As to what was in these technical papers?

Mr. WILDE. Yes.
Chairman PATMAN. All of them or just part of them?
Mr. WILDE. All of those that seemed relevant and needed for the subject that was before the Commission at that particular meeting.
Chairman PATMAN. Would you submit for the record a complete list of all the technical papers in the office?
Mr. WILDE. I am sure we could do that.
Chairman PATMAN. For the record, not for inclusion in this record to be reprinted, but just for the benefit of the committee, to be inserted later, if desired.
Would you submit for the record the complete list of all technical papers in the office?
(The list of papers appears in the appendix, p. 474.)
Mr. WILDE. I see no reason why we cannot, Congressman.
Chairman PATMAN. All right, sir, fine.
How did the Commission go about formulating its report? In other words, who suggested what was to go into the original draft of the report?
Mr. WILDE. Mr. Chairman, in order to get along with our work, the structure of the Commission was broken up into task forces, and those topics which seemed to be reasonably homogeneous were treated by the task forces in earlier meetings of task forces only, and then their tentative conclusions were coordinated into the Commission as a whole by having meetings of the Commission as a whole.
Does that answer your question?
Chairman PATMAN. Yes, sir, I think so.
I would like to know this. On a question of importance, did you have a vote, members in favor of it recorded, members against it recorded?
Mr. WILDE. We had that from time to time when very debatable issues came up, notably selective controls, changes in the Federal Reserve structure, important things. It was generally found—and it is amazing, I think it is a great credit to the members of the Commission—that after study and review they reached a consensus on most things without any need of a formal vote.
Chairman PATMAN. How many votes did you take? Would you say a dozen?
Mr. WILDE. I would think it was of that order. It might have been a few more.
Chairman PATMAN. And you have all the propositions that were voted on and how the members voted on that?
Mr. WILDE. I think so. We might not have it recorded, Dr. Fox tells me, by specific names, but we have the subjects and the count probably recorded.
Chairman PATMAN. Did you, Mr. Wilde, consider the significance of the number of commercial banks decreasing in this country in the last 40 years? The number has gone down during this period which is the greatest growth in our history, of course, and our population has gone up tremendously during the past 40 years, but during that time the number of commercial banks has gone down from 31,000 to 13,500. That seems alarming to me.
Did your committee go into that to determine, if possible, why the number of commercial banks are going down all the time during the greatest growth of our history?

Mr. WILDE. I do not think we examined that in detail. It came into this overall recommendation that the total facilities of the country should be increased by various measures that we recommend so that the public in terms of making deposits and in terms of places to go and borrow money would have increased facilities, and I assume that was in the back of our mind because we were well aware of this decline in the total number of commercial banks.

Speaking for myself only, I, of course, attributed it to the automotive age. We are no longer conditioned by foot travel and short distances, and I assume that one of the reasons stemmed from that.

Chairman PATMAN. My time is up and I shall not pursue it further.

But in the discussions I hope someone will answer for the Commission why they recommended that in "metropolitan areas" branch banks would be permitted to cross State lines. In that way we might have only a few branch banking systems obviously and then perhaps a holding company could connect up the branch banking systems of these metropolitan areas and in the end we would have very few people controlling the banking system.

I do not have time for you to answer that because my time has expired and I am yielding to Senator Bush. But I hope somewhere someone will answer that question I have raised.

Senator Bush?

Senator BUSH. Mr. Chairman, I see that Mr. Wilde is going to testify tomorrow morning again on the subject of monetary policy, is that right?

Chairman PATMAN. I think the agenda has him on for tomorrow morning.

Senator BUSH. And I understand that the plan is—is that your idea—that we confine the morning to the discussion of monetary policy?

Chairman PATMAN. No; it really was not, but I got into that on the last. But you just proceed in any way you desire, Senator Bush.

Senator BUSH. I did not want to get into repetitive matter.

Chairman PATMAN. What you ask today just do not ask tomorrow and vice versa, I assume.

Senator BUSH. I thought maybe you were trying to parcel the record out.

Chairman PATMAN. I have tried to do that in the past, but I have never been successful, so I have decided not to try it any more.

Senator BUSH. I would like to go back to where you are talking about the question of controls.

Does this apply to installment credit controls?

Mr. WILDE. What is your question, sir?

Senator BUSH. My question is: Did the Commission study the question of giving the Federal Reserve Board standby powers in respect to consumer credit controls, particularly installment credit; and, if so, what was the conclusion on that?

Mr. WILDE. The Commission gave a great deal of attention to this area. They discussed the evidence such as the Federal Reserve Board's study.

They talked about their own experience, those who were in the lending business. It was given as much analysis as the evidence and the experience of the members would permit, and this almost even break was the result of the different judgments of the evidence.

For example, one of the questions that was brought up was the administration of selective controls, the various opportunities that people would have to get around them and create a preference in their favor over someone else who did not know how to buy an automobile and escape controls. There were all kinds of detailed discussions on these points. Also, we debated as to whether the impact on the economy was as destabilizing as some people think.

And, as I say, the end result was a strong difference, about half our group being sure that it would make no important contribution and the other half being equally convinced that it could make a contribution to economic stability.

Senator BUSH. So you might say that the Commission was pretty well divided?

Mr. WILDE. Yes, they were.

Senator BUSH. On this whole question of standby controls on consumer credit?

Mr. WILDE. That is right.

Senator BUSH. Since your report was formulated, there has been a book published, "Buy Now and Pay Later," which is a very interesting book, because it shows the extent to which consumer credit has been increased in recent years.

My own feeling is that it is rather an alarming problem. That is why I wondered whether the Commission found any cause for uneasiness about the extensive use, the very marked increase in use of consumer credit in recent years?

Mr. WILDE. As I say, Senator, half the Commission were concerned and thought that measures should be started to develop effective standby controls, and the Commission also discussed the two other areas which have been criticized as destabilizing, the fluctuations in inventories and the fluctuations in plant and equipment expenditures.

There was very little support for any controls or standby controls in respect to those matters.

Senator BUSH. Mr. Chairman, I am going to reserve the rest of my questions for discussion on monetary policy.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Wilde, I want to congratulate you on a splendid statement, and also on this historic and tremendously impressive report of the Commission on Money and Credit.

I am very encouraged by it. It is remarkable that you could get this diverse a group of scholars, economists, businessmen, labor representatives, farm representatives, to come together as you have done here and make these specific and far-reaching recommendations.

I think it is most encouraging, indicating in this area where we have such strong feelings and such differences of opinion, that there is some real prospect of substantial progress.

I am especially impressed by your statement on page 4 at the top of your statement that you have presented to us in which you stress that the status of the individual must be of paramount concern, and you place great emphasis on the private economy.

You say that here is the bulk of our national production and here is where our concern should be the greatest.

I think the fact that you, speaking for the Commission, take this position is most encouraging.

Now, I would like to ask you this. I intend to get into some of these things tomorrow, but I think it is very, very difficult to segregate these questions.

You first begin to discuss a specific problem where you just touch on the recommendations that you make with regard to the tax rate, and you indicate that maybe the President should have some authority to vary the tax rate to achieve a greater degree of stability. This, of course, is a very controversial and far-reaching recommendation.

It is one that many of us in Congress would be extremely hesitant about, although it has a lot of merit.

I am wondering, in view of the fact that this is a report of the Commission on Money and Credit, why there is not a comparable recommendation with regard to the expansion of our money supply.

I am very much concerned with the fact that we have had a vast increase in our gross national product in recent years and the money supply has been fairly stationary, or at least the ratio between the money supply and gross national product has sharply declined.

It seems to me that this has acted as a great restraint in a great economy where we have so many idle resources.

Mr. WILDE. The monetary section of our report is relevant to your question because we do say there that the money supply needs to be related to the growth needs and capacity of the economy.

We treat with that in the monetary section. I did not discuss it in this introduction here.

Senator PROXMIRE. You do, indeed, but I feel there is not the same kind of specific recommendation that the growth of the economy be encouraged and be given some initiative and drive from an expansion of the money supply.

In other words, there is much more concern, I feel, with stability than with growth.

Mr. WILDE. There was a great deal of discussion in that area and that was one of the places where a formula or any specific figure was finally decided against as not being as useful as leaving it to the competent judgment of the Federal Reserve Board, which could evaluate all the elements.

You are well aware of the increase in velocity that has come around through variou devices, better inventory controls, and that sort of thing. We have been using our money supply more effectively.

And, furthermore, if you look at it historically, the money supply was larger than we needed. It was not really working, so that the change is partly just a practical matter of using our money supply more effectively.

Senator PROXMIRE. This argument about velocity, of course, whenever you have a situation in which the money supply is contracted relative to the gross national product, by definition, you have an automatic compensating increase in velocity. I am just wondering if this is very satisfactory.

Now, I would like to get into one other area very quickly, because I would like to ask this question, if possible, before my time runs out and on this round.

On page 38 of the report on money and credit, you have an extremely interesting discussion that I have not seen before. I think it is a great contribution to this notion of the effect of increases in demand on the price level.

You argue that where you have 8 percent unemployment, the effect of increasing demand on the price level is virtually nil; whereas, where you get down to 4 percent and then 2 percent, the effect is more direct and obvious. First, I wonder if you can tell me whether or not this 8 percent figure is based on an extensive study of experience in the past?

Mr. WILDE. I would answer you by saying that these figures were for illustrative purposes.

They came from scholars who had looked into the apparent relationship and they thought that these figures gave a good idea of how it probably worked.

But they are not supposed to be scientifically determined, because, to me, as not an expert in these fields, all they say is the commonsense one.

If you have a lot of people who are not yet at work and you have some idle capacity, of course, there is not going to be any pressure on the price level and as you get down to the other end there is.

The figures are to illustrate that broad concept and are not precision figures.

Senator PROXMIRE. It is commonsense, but there is a tremendous amount of difference of opinion between, for instance, the Chairman of the Federal Reserve Board, Mr. Martin, and the Chairman of the Council of Economic Advisers right now as to whether or not, because of various frictions in a situation, because of technological unemployment, because of the lack of appropriate skills and so forth, you can say where you have a situation now, we have, I think, 6.8 percent as of June, the latest figure I have, of the seasonally adjusted labor force out of work, 7.3 percent of the unadjusted out of work, whether you can increase the money supply and increase the pressure on resources through fiscal policy and so forth without inflation.

I read in the paper this very morning that the monetary experts are considering a contraction having an effect on the economy that would be deflationary.

In view of what you say here and what is apparently supported by almost the unanimous statement of this commission, that would hardly be appropriate policy at this point, is that correct?

Mr. WILDE. I would say that our presentation here suggests that a much lower figure of unemployment would be needed before the pressures on the price level were severe.

You are well aware that in certain trades like the building trades, there is a shortage of apprentices and of trade people, and you could have certain sectors of the economy where the national level of unemployment being too high, there would be pretty severe price pressure.

Senator PROXMIRE. I am going to reserve the rest of my time.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Mr. Chairman, first, I certainly want to extend my appreciation, and I know the appreciation of the Congress, for the study that your Commission undertook. Regardless of

whether we agree or disagree, it certainly has stimulated a lot of thinking, necessary thinking, in this area.

I want to deal with matters with a broad brush because I think that is what the introductory witnesses are dealing with, and try to get through semantics, if I can, to the actuality.

It seems to me that there are two kinds of monetary policy that we can have. One is the policy of neutrality, and complete neutrality, which, as I understand it, has our money supply expand in accordance with what occurs in the economy. As we have economic growth, the money must expand to have the adequate supply necessary as the economy is larger.

The other policy is one that differs with neutrality and would actually use monetary policy to effect employment or to effect economic growth.

I would if you would comment first on that. Do you see two very distinct kinds of monetary policy:

That which would be strict neutrality and that which would in varying degrees—and there could be considerable difference, of course, once you decide that you would—use monetary policy to deliberately minimize unemployment or to use it deliberately to try to maximize economic growth?

Mr. WILDE. As you know, the report says in overall that monetary policy as a restraint is liable to be more effective than monetary policy as an overall stimulus to the economy.

Representative CURTIS. Yes, sir.

Mr. WILDE. I do not recall that the Commission made the sharp distinction that you make. I know, of course, from reading in the press, magazines, and other articles that there are those rather strong schools of thought.

But the Commission, I think, felt that, as we have said, monetary policy should be a useful and an important instrument in aiding the natural growth of the economy, but it would not be able to do it alone.

Representative CURTIS. Then you are—and I think you are—advocating a policy that is other than strict neutrality? Those who take the strict neutrality viewpoint—and I am one who does—feel that the best way we aid growth is by preserving money as best we can as an economic measuring stick of the value of goods and services, the value of labor, the value of savings, and from the standpoint of economic statistics enables us to have some intelligent knowledge of where we are going.

Under that policy—and unless I mistake it, it is the sense of the policy that Mr. Martin, Chairman of the Federal Reserve Board, advocates—there are areas where judgment has to be exercised on monetary restraint or expansion, but it all relates, as best it can relate, to what is going on economically, and it is an attempt to keep the money supply in tone with what is going on in the private sector.

Now, I see a basic disagreement in the Commission's report, with one which seems to adopt the theory of a strict policy of neutrality. Would I be right in concluding that that is so?

Mr. WILDE. I think you would be right in this:

That the Commission goes a little further than a policy of strict neutrality.

But I am quite sure, as I heard the discussions and as I read our report, we do not go to the other side and say, if you just make money very easy and abundant, then the economy will take care of itself.

Representative CURTIS. I appreciate that.

I am just trying to get this straight in my own mind as to what has been advocated here. I know that you do not go that far, and, of course, I am very happy that you do not. I was disappointed, though, that there was no one on the Commission who seemed to follow the economic theory of the strict neutrality of monetary policy and the necessity for it to attain the very things that we are talking about.

Now, one other thing, on monetary policy.

One of the big issues, of course, as I see it today, is if money—the monetary policy is to be neutral, then we try to remove it from the political arena and put it into the economic area, and that is the theory, at least it seems to me, behind the independence of the Federal Reserve Board.

I do think that this is getting into detail and perhaps I should not discuss the detail here, but I might point it up. When you change the Chairman of the Board to be named by the President and to coincide with a political term, no matter what you are saying, it is, to that extent, putting monetary policy in the political area, and I think you argue that it should be, to some degree.

Am I fair in that interpretation?

Mr. WILDE. Yes, I think you are fair in that statement, sir.

But the Commission feels that with a requirement that the Chairman come from the Board and with 10-year terms of office, the opportunity for the President to take a particular individual that he thinks would be most congenial to him does not deny or interfere in any important way with the independence of the Federal Reserve.

Representative CURTIS. I see.

Your point is that you essentially are preserving it in the economic sector, to use my figures of speech here?

Mr. WILDE. Yes.

Representative CURTIS. But, to that degree, it does bring it into the political arena and, in your judgment and that of the Commission's, that there should be that reflection.

Now to fiscal policy, and this, to me, is more disturbing, because there, too, we have a school of thought that feels this way.

First, let me divide fiscal policy into two sectors: one revenue and the other expenditures.

At least as far as the revenue aspects, taxation, that that should be neutral, and again I happen to be one who believes that our tax policy should be as neutral as we can make it. Yet, I take the recommendations here of your Commission to go away from what I think has been a classical and traditional approach of the Ways and Means Committee, and those who have been dominant in the Treasury Department, at least to have as our goal neutrality in the way we collect our revenues and not try to effect an economic result.

You do recognize that there is that departure?

Mr. WILDE. The Commission recognizes it, it seems to me, in two respects.

First, we say that the basic tax structure ought to be reviewed from time to time because it has grown so large that it has an impact on the economy whether it is intended or not. Originally, it was not as you said.

Representative CURTIS. That is right.

Mr. WILDE. But it has become of such size that it affects the economy.

So we say that it should be reviewed from time to time. But what we are dealing with in this special idea is not a novelty in the sense of its being an invention of the Commission. It has been discussed by economists and students for quite some years now.

It was discussed very actively, you will recall, in the spring of 1958 under the previous administration.

Representative CURTIS. I know it has, and our studies of the subcommittee of this committee back around 1956, I think it was, went into that very thing.

Mr. WILDE. Yes.

Representative CURTIS. I am quite familiar with it. All I am trying to point up is that that is a very definite departure from the traditional theory. I happen to believe that we badly need to review our tax structure, but this can be done in context of a policy of tax neutrality.

I also agree that whether we like it or not, taxes do have an economic impact. But there is a difference as to whether you try to maintain neutrality or whether you are willing to go along and actually try to effect economic results, and I think this would be a departure.

Mr. WILDE. Yes.

Representative CURTIS. I see my time is up and there is only one final comment I would like to make.

I think it is in the area of governmental expenditures that we very properly get into the field of policy. It is in that area that I think the governmental policy deliberately is made, which will affect the economy. The theory, that I hold and I think some others do, is that monetary policy and the revenue aspect of fiscal policy should be as neutral as we can keep it. Then let us get into this other area of expenditure and possibly in the area of Government regulations of the deliberate attempt of the Federal Government to effect economic progress, employment, growth, and so on by conscious policy decisions.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. I, too, Mr. Wilde, would like to congratulate you and your associates for the very useful job you have done.

As you point out in your statement, it was not possible for there to be a congressional study or an executive study or a joint executive-congressional study in those circumstances.

The private study by public-spirited participants, which has resulted in the report on money and credit, is going to be very helpful, and I would look forward to some legislative attempts next year to bring about solutions to some of the problems that you have touched on.

I have just one question suggested by your statement here this morning.

In your written statement you quote approvingly from one of the passages of the report in which it is said that:

The Federal Government must have a set of policies with respect to the level and composition of its expenditures, the structure of tax rates and composition of the debt, and terms on which it grants, insures, or guarantees loans, and the size of the money supply. And clearly it makes a difference what those policies are.

That is the end of the quote.

I would just like to say that I am glad that you did quote that. I think it is one of the most significant passages in the report, and I take it that it represents the view of yourself and your associates on the Commission that these basic decisions affecting our economy are indeed policy decisions that have to be argued out in the marketplace of ideas, in the Congress, in the executive branch, and with the aid of private groups like yourself.

Is that a fair statement?

Mr. WILDE. Yes, it is.

Representative REUSS. In the light of that, that underlying philosophy with which I have indicated my hearty approval, I was somewhat surprised and disappointed, as certain members of your Commission were, at the basic conclusion on growth which is set forth on page 31 of the Commission report, where the key sentence is the following:

Although not satisfied with recent rates of growth, the Commission does not recommend the establishment of any specific rate of growth as a target.

You address yourself to that failure of the Commission to make any recommendation, in your statement here this morning, and one of the reasons you give, on page 9 of your statement, is that setting a percentage goal for long-term growth might well result in continuous political debate.

Now, my question is this:

What is so bad about continuous political debate? Is that not one way that the Executive and the Legislature of this country can move toward the kind of economic goals that the people in a democracy want, and would it not have been perfectly possible to try to delineate some sort of goals not to be met in any particular year perhaps, but to be met over a period of years?

And, finally, if the Commission was able to decide that it was dissatisfied with the recent growth rates—I think in the period we are considering it was something on the order of 2.5 percent a year—why were you not able to pick out a figure which you thought would be a more useful goal?

I would like to have your comment on that.

Mr. WILDE. Those are very fair questions.

First, let me say I have no objection to political debate. I think it runs to the essence of our democracy. But in the light of the times, it could be rather bad for our morale, as it has been in the last few years, for people to say that we are so inefficient that we are going to be overtaken by the Russians and so forth, when we are talking about things that are not precise numbers.

There are no growth figures of a strictly homogeneous nature among the countries of the world.

We believe that the Germans and the Japanese, maybe some others, may have grown in recent years at a higher rate than we have grown.

But you do not know it in any precise sense. Therefore, you can get into a debate which is not based on a valid premise. But, more important, with the work of the Congress in trying to help the economy with any recommendations that we might have that are useful, if you people believe that we can have a steady upward path, that we will fluctuate. So if you picked out a figure, 4 percent or 5 percent, and we will get interim fluctuations, we are so emotional we could get very unhappy and very disturbed.

The Commission did say that figures of 3½ to 4½ percent seemed as though they might be attainable, but the figures that have been used have run up as high as 6 percent, which is illustrative of the fact that we cannot agree in these matters, entirely aside from the matter of measurement of it.

The Commission spent a good deal of time on it because there were members who would have liked the precise figure, as you would.

But the consensus came down, as we have stated, that it was better to state our objectives in broad terms, suggest ways of getting there, use figures as illustrative, but not precise, target goals.

Does that answer your question?

Representative REUSS. What baffles me is how the Commission could, as an intellectual matter, come to the conclusion that it was not satisfied with the existing 2½-percent rate, yet equally declare it impossible to pick out a rate which would satisfy it, allowing for fluctuations from year to year. I am talking about a rate which would hold for, say, the next decade.

Mr. WILDE. You recall that the historical growth of the country has had an amazingly consistent pattern, running around 3 percent for 100 years or more.

A figure like 5 percent would be, you might call it, a 66-percent improvement in our performance, not 2 percent, and that would be quite an undertaking in the minds of many of the members of the Commission. Even 4 percent is a 33⅓-percent increase in performance.

Representative REUSS. I note that Mr. H. Christian Sonne, a member of the Commission, in his footnote on page 5 of the Commission report said that he was preparing a separate statement which would be published in due time.

Has that been prepared and is it published?

Mr. WILDE. Yes, it has, and I presume that upon request of your committee we would be very glad to file it with you. I do not happen to have it here.

Representative REUSS. I think it would be interesting.

Mr. Chairman, I would ask that——

Chairman PATMAN. We have it. It will be made a part of the record, if you desire.

Representative REUSS. I request that it be made a part of the record.

Chairman PATMAN. Mr. Sonne is testifying on Friday. Would it be satisfactory to wait until he testifies?

Representative REUSS. Sure.

No further questions.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you, Mr. Chairman.

Mr. Wilde, I, too, would like to congratulate you on the report and on your remarks here this morning.

I thought most interesting in the report were the footnotes, because I thought that they showed a dissension actually among the committee, and they showed strong ideas on the part of each individual.

Personally, I read them with some interest.

I would be interested in knowing how, on page 10, these words got into the record:

> A primary duty of government is to provide an appropriate climate and set of conditions to enable private enterprise to meet our economic needs through a competitive market system to a maximum extent practicable.

Do you recall how that was put into the record? I was quite interested that there were no footnotes to that remark.

Mr. WILDE. It was put into the report as a premise, as my philosophical remarks in my introductory remarks this morning were introduced to give a point of departure for many things that might be inconsistent if you did not have that kind of a basis in your philosophy of such a report.

Representative GRIFFITHS. And did everybody agree that that was a primary duty of government?

Mr. WILDE. I would say that not only were there no dissents, but I do not recall any Commissioner who was at all anything but glad to see it in there.

Representative GRIFFITHS. I would like to say that I think that statement you made this morning is a much happier statement. The role of government in our society is primarily to make possible and to preserve opportunities for the individual. I think that is a better statement, although I do not really agree with either statement.

I would assume that the primary responsibility or reason for government is to maintain order within the boundaries, and in this morning's world maintain peace from without. And anything added to that, it seems to me, is sort of a sophistication.

You state:

> When intelligently and purposefully discharged——

Mr. WILDE. That is my introductory remarks?

Representative GRIFFITHS. In your statement this morning. [Continuing:]

> they place government not above the individual, but as his partner.

Could you give me an instance of your thinking where government is your partner?

Mr. WILDE. Yes. I think that government is the partner of the people in terms of both the material things, and we are using "government" here in the broadest sense.

We expect that government will provide the educational system; we expect that government will provide the road system; we expect that they will help in regulating many private activities that run across the board such as utilities, transport, and so forth.

It is not to be taken in a narrow or literal sense, although we even have that phenomenon in some respects. We have partnerships in States and local communities, and in public authorities and various things.

But there is a partnership responsibility between various units of government, and not simply the Federal Government alone.

Representative GRIFFITHS. You were thinking of when government contributes things within the public sector of society, that it acts as a complement, not necessarily in a narrow sense of partnership?

Mr. WILDE. That is right.

Representative GRIFFITHS. So that it is almost too broad to say that government is ever a partner with the individual. Government is not a partner with the individual.

Mr. WILDE. In any narrow sense, I am sure I would agree with you. But in the broad sense that we were using it, I would say that it is permissible phrasing.

Representative GRIFFITHS. I would think that government is a fair and impartial arbiter between men.

You have pointed out in your statement this morning—and I agree with you—that the

Commission strongly believes that there is no need to accept inflation as a way of life in this country. Quite the contrary, the report points out that inflation is a serious enemy of real and sustained progress.

Would you say that within the last 20 years this country has had serious inflation?

Mr. WILDE. If you take the two periods, and I may not recall the exact periods, there has been very little inflation, as normally defined, in recent years, but if you go back from the period before the war to the price level through, I would say, about the early 1950's, you had inflation from my point of view and from the point of view of thousands and hundreds of thousands, if not millions, of our citizens. To cut the buying power of your money in half is pretty serious.

Representative GRIFFITHS. Would you say this country has had more or less inflation than other nations?

Mr. WILDE. I think you will find that the story is both ways; that there are a few countries which were not involved, such as Switzerland, probably, and some others, that had much less, and there are certainly other countries that have had a great deal more than we have had.

Representative GRIFFITHS. But, on the whole, throughout the world our dollar is regarded as stable, is it not?

Mr. WILDE. I would like to say "Yes" without any equivolcation, but in view of the international balance-of-payments situation, which is quiescent and superficially favorable at this time, I do not think I can say unequivocally "Yes." I think our dollar is highly regarded, but I do not think it has the same absolute confidence that it had 3 or 4 years ago.

Representative GRIFFITHS. Thank you.

Thank you very much, Mr. Chairman.

Chairman PATMAN. Senator Douglas?

Senator DOUGLAS. Mr. Wilde, on page 61 of your report in dealing with the question of the longrun growth of the money supply you say:

The average rate of growth of the money supply should reflect the rate of growth of real output at high employment and stable prices.

And then there are certain qualifications you make subsequently.

I take it to mean that you believe the money supply in the long run should be expanded at approximately the rate of national growth in the gross national product, is that correct?

Mr. WILDE. Yes.

Senator DOUGLAS. So that if we were to have a rate of growth of 3½ to 4 percent, the money supply should be expanded roughly in correspondence to that rate?

Mr. WILDE. I would think so because I do not think that philosophy could accommodate—under average conditions it might at the time, but, generally speaking, I would think the money supply had to parallel the rate of real growth.

Senator DOUGLAS. And that failure to increase the money supply at this rate will operate in a restrictive fashion?

Mr. WILDE. Do I think it would be restrictive?

Senator DOUGLAS. Yes. Failure to increase the money supply at approximately that rate will have a generally restrictive character?

Mr. WILDE. I would think so; yes, sir.

Senator DOUGLAS. In the expansion of the money supply, of course, there are two main ways of effecting this:

First, by lowering reserve requirements, which has been the policy followed, in the main, by the Federal Reserve Board in recent years; and by open market operations.

On page 67 of your report you say that you believe that:

> The power to change reserve requirements should be used only sparingly and the Commission favors major reliance on the use of open market operations for countercyclical adjustments.

So that you look forward to the best policy of expanding the money supply, not by further lowering of the reserve requirements, but by open market operations, is that correct?

Mr. WILDE. That is correct, sir.

Senator DOUGLAS. Then, third, the type of securities which are to be purchased under the open market operations, on page 64 you state:

> The Commission recommends the continued use of open market operations as the normal or usual instrument of general monetary policy.

This is a reinforcement of the other statement.

> Instead of relying on a bills-only policy, the Federal Reserve should be willing, when domestic or international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varying maturities.

Do you want to expand that, because this has been contrary, this is contrary to the declared policy of Mr. Martin, the Chairman of the Federal Reserve Board?

Mr. WILDE. As you know, Senator, this is a very involved subject with different degrees of approach to it. Let me answer it first backward.

You will notice the Commission is unequivocal in stating that they do not believe that lengthening and broadening the spectrum of operations should permit and degenerate into a pegged price.

Senator DOUGLAS. Oh, quite, quite.

Mr. WILDE. But within the bills-only and the longer maturities, there is a good deal of room for useful maneuver in the economy.

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One of the reasons, which is not spelled out here, is the desirability from time to time of helping the market. The market is not very good for long-term securities because the buyer of long governments prefers to buy a corporate at a higher yield, and, yet, there ought to be some market, so that is entirely aside from direct monetary impact.

But this would be an orderly thing, in the opinion of the Commission, to have the central bank in its open market operations use the different securities that are out, in accordance with their judgment at the time, without any precise formula or measurement.

I do not know whether that answers your question, but that is the way the discussion went.

Senator DOUGLAS. Of course, these three recommendations—first, that the money supply should be expanded in rough proportion to the increase in the real gross national product; second, that the expansion should take place through open market operations rather than a further lowering of reserve ratios; and, third, that the purchase of Government securities should not be confined to bills but should include a very large proportion of long-term securities—were recommendations which the majority report of this committee made a year and a half ago and which were very bitterly criticized at the time by certain individuals.

It is very reassuring to find that your committee, with the composition that it has, has on these points, and, indeed, on many others, come to the same conclusion that we did. Naturally, this pleases us, and I want to congratulate you on your perspicuity.

Now the next question I want to ask is on Treasury policy and debt management.

As you know, in the sale of longtime securities it is the practice of the Treasury to have these bonds floated at par, and when the quantity demand exceeds the supply, which it always does with one exception, I think, then the amounts allotted to individuals are rationed between the security dealers and purchasers.

The majority of the joint committee recommended that this policy should be changed, putting the bonds up for auction in order to get a competitive price on them, in the belief that when the quantity demand exceeded the supply, this was an indication that the price fixed was less than a competitive price.

I am happy to note that on page 115 you recommended that:

> The Treasury should continue to experiment further with the use of the auction technique.

So you believe that at least further experiment should be carried out in this direction?

Mr. WILDE. I think probably the Commission meant even more than that; that in matters of public debt you should supply the merchandise by trial and error, in part, that the public will buy. It is as broad as that in its intent.

Senator DOUGLAS. I again congratulate you.

Now I notice you recommend that the membership on the Federal Reserve Board should be 5 rather than 7; that the term should be 10 years rather than 14; that the Chairman and Vice Chairman should be for 4-year terms, coinciding with the term of the Presidency; and that the President, therefore, should have the power to

pick a Chairman and Vice Chairman from the membership of the Board.

Would you explain your thinking on this point?

Mr. WILDE. Senator, as you perhaps know from your record, perhaps you can get a more adequate answer from my associate, Mr. Eccles, who is going to testify.

I would answer you by saying, as I said to another member of your committee, that it seems a rather logical thing, when a new administration comes into power, with its policies that have been thrashed out in the political arena, to pick from a preselected group those men to work with you whom you thing are more personally simpatico. You still do not control and direct them, but they are congenial to your thinking, you hope, and you must work with the Federal for 4 years, and the Federal must work with the administration, because, while they are independent and responsible only to Congress, they have to have a working partnership. They are not operating in a vacuum.

Senator DOUGLAS. Pending the change in the law on the term and choice of members, would you say it would be a gracious act for the Chairman of the Federal Reserve Board to offer his resignation to the incoming President when the new President assumes office?

Mr. WILDE. Senator, I do not think it would be right for me to suggest what is the proper conduct of a Washington official.

Senator DOUGLAS. This would seem to be carrying out the principles of your report.

Senator BUSH. Mr. Chairman, I object to that question. I think that is obviously directed at Chairman Martin, and it is a question of personal conduct and behavior, and I do not think it has any place in the hearing.

Chairman PATMAN. I do not think the Senator will insist on an answer.

Senator DOUGLAS. No, I certainly do not insist on an answer, but I think it is a logical question which flows from your report.

Senator BUSH. It may be a logical question, but this is not the place to ask it.

Senator DOUGLAS. I think any place is proper for discussion provided the question does not reflect or impugn the personal character of anyone.

I certainly have never impugned the personal character of Chairman Martin.

Mr. WILDE. Senator, it was not discussed by the Commission, and since I am reporting for the Commission, in that sense, I do not think I would have a proper reason to answer.

Senator DOUGLAS. Mr. Chairman, I will not take up any more time, but I would like to have printed in the record a statement that I put into the Congressional Record shortly after the Commission report was issued, indicating there were 13 crucial points on which the Commission agreed with the majority report of this Committee on Employment, Growth, and Price Levels; and that since then we have discovered other sources of agreement.

I had a very high opinion of you, Mr. Wilde, before you began your study. I have an even higher opinion of you now, and, as we discover further points of agreement, why, my opinion will rise even more.

That is all, Mr. Chairman.

(The statement referred to follows:)

THE REPORT OF THE COMMISSION ON MONEY AND CREDIT

Mr. DOUGLAS. Mr. President, the long-awaited report of the Commission on Money and Credit, established by the Committee for Economic Development, and sponsored by several of our large foundations, was released yesterday. This Commission, made up of a diverse group of distinguished Americans, assisted by an able staff and a group of advisers of great competence, has been considering the structure and policies of our monetary institutions. The Commission's report will undoubtedly receive and certainly deserves a great deal of study and consideration and I have no doubt that it will get it.

As in any such Commission report, there is much with which one can agree and disagree. I am sure that on further study, I will find some specific proposals with which I cannot concur fully, or perhaps approve. These points will come out as one has an opportunity to study the Commission's report more thoroughly.

At the same time, it is gratifying, to find that this distinguished and conservative group of men from the business, banking, and professional communities, after mature consideration and study extending over nearly 3 years, has come to many of the same conclusions and recommendations which I have been urging based upon my study as a member of the Banking and Currency Committee and as a member and sometime chairman of the Joint Economic Committee. It is not only gratifying but I suppose we in Congress should feel reassured that many of the principles advocated in our reports have received acceptance from this distinguished group.

When the Joint Economic Committee ended its yearlong study of the economy in January of 1960, we made many similar recommendations. We thought that these recommendations were well thought out, orthodox in conception, and aimed at a more competitive and more efficient economy. But our recommendations were opposed by most of the banking community, by almost the entire financial press and financial writers, and by most of the Republican members of our committee. I have seldom received such a tongue lashing as was meted out to me at that time by some of my Republican colleagues.

Now we find that this distinguished group of people have made numerous recommendations which are either very similar or in some cases exactly like those which we Democrats on the committee made.

I am very pleased with this fact. I think it vindicates our recommendations. I hope that the banking community, the financial papers and financial writers, and some of the leading members of the minority party in the House and Senate may at long last give us some of the credit which was originally due.

While my examination of the items is limited because of time, I would like to cite a few of the many parallel recommendations between those of our committee or of myself and the Commission on Money and Credit.

First. In the 1960 Joint Economic Committee report, presented while I was chairman in the last Congress, as well as on numerous other occasions, we have urged "in the area of monetary policy, we offer as a general prescription, that the supply of money—that is, currency held outside banks and adjusted demand deposits—should increase over time at about the same rate as gross national product, allowing for normal velocity," page 15.

The Commission on Money and Credit, coming to a similar conclusion, states:

"The relatively slow growth of the money supply since 1951 was, in considerable measure, a reflection and embodiment of the generally restrictive tone of monetary policy.

"The average rate of growth of the money supply should reflect the rate of growth of real output at high employment and stable prices" (p. 61).

Second. The majority of the Joint Economic Committee have repeatedly recommended that "the Federal Reserve System should abandon its bills only policy"—"Employment, Growth, and Price Levels," Senate Report 1043, 86th Congress, page 34; 1960 Joint Economic Report, Senate Report 1152, 86th Congress, page 16.

This recommendation was bitterly fought by the Federal Reserve Board itself and bitterly fought by the financial writers and by most of the Republican members of the committee.

The Commission, in recommending the use of open market operations states:

"Instead of relying on a bills only policy, the Federal Reserve should be willing, when domestic or international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varied maturities" (p. 64).

Third. The Joint Economic Committee last year included, as a major recommendation:

"The Federal Reserve should use open market operations rather than lowering reserve requirements as the means of bringing about the secular expansion of credit which the Federal Reserve and the banks desire" (S. Rept. 1152, p. 16).

The Commission states that it "believes that the power to change reserve requirements should be used only sparingly and favors major reliance on the use of open market operations for countercyclical adjustments," page 67.

Fourth. Nearly 10 years ago, a subcommittee, of which I was chairman, stated:

"We recommend that all banks which accept demand deposits, including both member and nonmember banks, be made subject to the same set of reserve requirements and that all such banks be given access to loans at the Federal Reserve Banks" (Document No. 129, 81st Cong., p. 2).

In the report just issued today, the Commission on Money and Credit "recommends that the demand deposits reserve requirements of all member banks be made identical and that the classification of banks into country banks and reserve city banks be eliminated," page 69.

Fifth. In the same 10-year-old subcommittee report, we recommended that—

"Every effort be made to build up the quality and prestige of the Federal Reserve officials; among these measures should be a reduction in the number of the members of the Board of Governors from seven to not more than five * * * and an increase in their compensation" (Document No. 129, 81st Cong., p. 2).

The Commission on Money and Credit, noting that—

"A reduction in numbers should enhance the status of members recommends that the Federal Reserve Board should consist of five members * * * occupation and geographical qualifications for Board members should be eliminated. Instead the statute should stipulate that members shall be positively qualified by experience or education, competence, independence, and objectivity commensurate with the increased responsibility recommended for them * * * the salaries of top officials throughout the Government should be sharply increased and in view of the gravity of their responsibilities, FRB members should be compensated at the highest salary level available for appointive offices in the Government" (pp. 87 and 88).

Sixth. The Joint Economic Committee has repeatedly urged the Treasury Department to place more reliance upon the auction method for selling not only short-term but long-term securities—Senate Report 1043, 86th Congress, page 47; Senate Report 1152, 86th Congress page 16; House Report 328, 87th Congress, page 39.

Mr. President, the joint committee urged this upon former Secretary of the Treasury Anderson again and again and again, but had no response.

The Commission on Money and Credit, urging that less reliance upon administrative pricing of Treasury offerings is desirable, recommends "that the Treasury should continue to experiment further with the use of the auction technique," page 115.

Seventh. In its report on "Employment, Growth, and Price Levels," the Joint Economic Committee noted that—

"Advance refunding * * * can be an important means of lengthening the debt. Through advance refunding, the Treasury substantially reduces the attrition which it ordinarily suffers when long-term issues are refinanced." (S. Rept. 1043, 86th Cong., p. 36).

The Commission on Money and Credit, noting that under the advance refunding technique, there would be less market "churning" recommends "that the Treasury continue to experiment with the use of advanced refunding technique," page 114.

Eighth. The Joint Economic Committee reported to the Congress some time ago that—

"The greatest contribution which debt management could make to the longrun attainment of our economic objectives would be to reduce its interference with monetary policy. A longer average maturity of the debt would help to attain this objective. The Treasury would have to come to the market less often and

the switching in and out of Government securities over the business cycle by financial institutions, which reduces the effectiveness of monetary policy, would be somewhat reduced" (S. Rept. 1043, 86th Cong., pp. 35 and 36).

The Commission on Money and Credit notes that—

"Regularization of Treasury offerings would reduce the difficuty of refunding operations occurring at erratic intervals. It would broaden the interest in Treasury securities, by encouraging the periodic allocation of funds for new Treasury issues by both individuals and institutional investors and by reducing uncertainty about the timing and maturity of new issues" (p. 113).

Ninth. The Joint Economic Committee has repeatedly urged and I am happy to say that with its promptings and insistence upon the disclosure of statistical information relating to the trading in the Treasury security market, data is now published weekly on the operations of the so-called 17 dealers in Treasury securities.

Mr. President, I assure the Senate that when this recommendation was first made, it was treated very coldly, indeed. In its report, the Commission on Money and Credit, having conducted most of its study before these statistics became publicly available, comments upon the desirability and "welcomes the publication of the new weekly data" (p. 120).

Tenth. One problem which has been of great concern to me personally on which I have commented in hearings before various committees on more than one occasion, has been the danger of placing too great confidence in our standard unemployment statistics since they make no allowance for what I call involuntary part-time unemployment.

The Commission on Money and Credit, after its extensive study, expresses a similar concern, noting that—

"The present system of reporting unemployment makes no allowance for the loss of man-hours, which occurs when people work fewer hours than they wish" (p. 24).

Eleventh. In its annual report this year, the Joint Economic Committee called for a review of the actions of the Federal Reserve Board and the Open Market Committee, as reported in the Board's annual reports, and just this month, under the chairmanship of Representative Patman, the trend of testimony seemed to suggest that there was much to be desired in this area of publicity respecting the exercise of these great monetary powers—page 47.

The Commission on Money and Credit, noting that accurate information would probably be less dangerous than rumors being continuously circulated about Federal Reserve policy, stated:

"Although there is no easy solution to this issue, the Commission believes that the Federal Reserve should follow the general rule that the public should be kept informed with reasonable promptness and with reasonable detail of the reasons for its policy decisions and actions in order to avoid misunderstanding and misinterpretation" (p. 92).

Twelth. In considering the solution to our balance-of-payments problem, the Joint Economic Committee, among other things, stated, in its annual report:

"We recommend elimination of the dollar gold reserve requirement, now equal to 25 percent of Federal Reserve notes and deposits. This requirement is irrelevant to both the supply of and the value of the dollar, and removing the requirement will reinforce the President's pledge, made in his state of the Union message, that the full strength of all our reserves stands behind the value of the dollar for use if needed." (H. Rept. No. 328, 87th Cong., p. 39.)

The Commission on Money and Credit has arrived at much the same conclusions:

"The Commission believes that threat of a confidence crisis would be greatly reduced if it were generally recognized, both here and abroad, that all of the U.S. gold is available to meet our international obligations. Any doubts about the U.S. policy should be removed by elimination of the gold reserve requirement at the earliest convenient moment so that all of the U.S. gold stock is available for international settlement."

Thirteenth. Upon a number of occasions we have commented on the need for coordination of monetary and fiscal policies, most recently in the Joint Economic Committee's annual report, where we state:

"We would be remiss if we failed to observe that present coordination of monetary and fiscal policies appears to be less than desired. * * * In any case, the Nation cannot afford to have the highest policymaking bodies of the Federal Government following conflicting policies, supported though they may be by dif-

ferent assumptions as to what the economic facts are." (H. Rept. No. 328, 87th Cong., p. 37.)

The Commission on Money and Credit recognizes this problem sufficient to offer one possible solution, namely:

"The FRB Chairman and Vice Chairman should be designated by the President from among the Board's membership to serve for 4 years coterminous with the President's."

Mr. President, I call attention to that recommendation and say that if it were to be carried out, the President of the United States would at this time have the power to appoint a Chairman and a Vice Chairman of the Federal Reserve Board.

Again, I find some satisfaction in discovering that these diverse experts gathered from the financial and business community have, after such thorough deliberation, come to much the same conclusions which some of us in Congress have been urging. I have listed only a few of them, I am sure.

But I hope that these conclusions will be noted by the financial community and writers and that they may now have the good sportsmanship to admit that our proposals were, in the main, sound.

Chairman PATMAN. Thank you, sir.

I think it is proper to add that Mr. Douglas was chairman of the committee, Senator Douglas was, at the time the report was made that he referred to, a year and a half ago.

Senator DOUGLAS. It may seem somewhat ungracious, Mr. Chairman, for me to say this but since I took some rather bruising comments, I think it is only important that the emolument of agreement should be spread upon the record.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. I am sorry that I was not here to listen to your earlier testimony, and I have not had a chance to read your statement.

As I understand it from past history, the Federal Reserve System was created to act autonomously and not controlled by political thinking. Am I wrong in that? Do your studies evidence something far apart from that?

Mr. WILDE. Of course, people have different definitions of what is independence and what is politics.

The Federal Reserve was set up, as I understand it, by the Congress in order to more effectively carry out its responsibility to the country in respect to money matters, because the Constitution said the Congress controls coinage, the value of money, and they set up this instrument to carry out their responsibility under the Constitution.

They wanted to remove it from the day-to-day impact of politics, but not the longrun impact, so they set it upon this independent basis.

Representative WIDNALL. Did your studies show that there was an incompatibility between the Chairman of the Federal Reserve Board and the Executive in the past?

Mr. WILDE. I would answer you by saying that that differed according to the judgment of some members of the Commission, but the general consensus was that there was only the kind of difference of judgment that comes into a professional field.

In the regulation of the money supply you are not dealing with a precise science. You are dealing with value judgments which can only come through experience, and different people have different ideas.

But I do not recall that there was any feeling on the part of the Commission or the majority that there was violent incompatibility from time to time in the last 20 years.

Even at the time of the so-called battle of the peg, which one of your distinguished members participated in, I do not think it was acrimonious. There was a difference of judgment on how you handle the country's money supply.

Representative WIDNALL. Would that finding not tend to support the present system rather than advocacy of a new system which could bring under the heel of politics the operation of the Federal Reserve System?

Mr. WILDE. It would if you feel that this is rather radical. The Commission, as I have testified, does not feel that it is particularly radical.

Representative WIDNALL. That is all.

Chairman PATMAN. Mr. Wilde, we will have you tomorrow morning and we will go to Mr. Eccles now, if it is all right with the members of the committee.

Mr. WILDE. Mr. Congressman, can I say——

Chairman PATMAN. Just a moment, please.

Representative CURTIS. I just have one question.

Chairman PATMAN. Mr. Curtis wants to ask a question.

Representative CURTIS. I have been trying to follow your theory on this changing chairmanship of the Federal Reserve, and I relate it to another area to see if this does not have the same context.

The same arguments, I should imagine, would apply if we changed the Chief Justice of the Supreme Court to be selected out of the present panel every time there is a change of Presidency. I think we would have a similar situation there, and I do think it would alter pretty basically the theory of the separation of powers, the one between the executive and the judiciary, the other between the executive and the legislative, this control over money being a legislative constitutional power.

The reason in our other regulatory bodies—for instance, the Comptroller General, which is an arm of the Congress—we give the President the power of appointments as a convenience, not to give control over it. That is one reason the terms of the personnel of these regulatory bodies are not in accordance with that of any President.

Do you not feel that the same theories are involved here, Mr. Wilde?

Mr. WILDE. In part, but not precisely, Congressman. The Supreme Court was set up as one of the tripartite arms of our theory of a democracy. But the Federal Reserve is the creature of the Congress, of the legislative arm, and if the Congress wants to make a minor gesture toward the administration, this would be a logical way to do it.

You see, under the present circumstances we have no logic. We have a term for the chairman which could be within the term of the new President 1 year, 2 years, or 3 years. It is not a very rational setup.

Representative CURTIS. Thank you.

Chairman PATMAN. Thank you, Mr. Wilde.

Mr. WILDE. Mr. Chairman, may I thank you and your members for your very kind words about our Commission.

It has been a very interesting but a very arduous duty at times. We can only hope it makes some contribution.

Chairman PATMAN. One question for the record. How much did you spend on this investigation and study?

Mr. WILDE. I do not have the final figures, and some of it, of course, was indirect in rent-free space and some help. I would think that, offhand, a good figure would be $1.5 million.

Chairman PATMAN. Thank you, sir.

Mr. Eccles.

We have as our next witness the chairman of the board of the First Security Corp., Salt Lake City, Utah, who was Chairman of the Board of the Federal Reserve System for 12 years, from 1936 to 1948.

I believe he served longer as Chairman than any other one person.

In addition to that, he served for 5 years as a member of the Board, making a total of 17 years' service.

I have a very pleasant recollection of the fine service that you rendered, Mr. Eccles, as Chairman of the Board and as a member of the Board, and I also remember the many forthright decisions that you made, and I recognize you as a very fine public servant, in the way that the phrase "public servant" is commonly and generally used and understood. In other words, a great statesman in that regard.

We are delighted to have you here as a witness, sir, in connection with this matter about which I consider you know as much or more about than any person in the United States. We are glad to have you and you may proceed in your own way, Mr. Eccles.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN OF THE BOARD OF THE FIRST SECURITY CORP., SALT LAKE CITY, UTAH

Mr. ECCLES. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I have a statement here I should like to read.

I am complimented to be invited to appear as one of the first witnesses before your committee in its consideration of the report of the Commission on Money and Credit. I was glad to know that you considered this report of sufficient importance to hold hearings so promptly after its public release.

Having spent 17 years in the service of the Federal Reserve Board and 3 years as a member of the Commission, I was glad to respond to Chairman Patman's request to appear before your committee to discuss the Commission's recommendations relative to the Federal Reserve System.

Time will not permit me in this statement to cover fully all aspects of the Commission's recommendations affecting the Federal Reserve.

I should first like to consider with you the historical background and current need for change. Woodrow Wilson, considered the father of the Federal Reserve System, had this to say in his first inaugural address:

> We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon, and step by step we shall make it what it should be.

Nearly a quarter of a century after the Federal Reserve System was established, the Banking Act of 1935, sponsored by Franklin D. Roosevelt, brought about the first basic changes in the System. In

1937, when President Roosevelt dedicated the Federal Reserve Building, he had this to say relative to the role the Federal Reserve plays in the broad purpose which the Government must serve:

> * * * (its) purpose is to gain for all of our people the greatest attainable measure of economic well-being, the largest degree of economic security and stability. To advance the country toward this goal is the primary mission of the Federal Reserve System. It cannot be attained by that System alone, but neither can it be reached without the proper functioning of our monetary and credit machinery. That machinery must be steadily perfected and coordinated with all other instruments of Government to promote the most productive utilization of our human and material resources. Only in that way can we hope to achieve and maintain an enduring prosperity free from disastrous extremes of booms and depressions. Only in that way can our economic system and our democratic institutions endure.

Twenty-six years have passed, or more than a quarter of a century, since the Banking Act of 1935. Many revolutionary changes have taken place in nearly every aspect of our own economy, as well as throughout the world. I believe we are living in the most revolutionary period in history. We are experiencing not only a revolution in science, but a political, social, and economic revolution as well. There is a tendency to look away from the realities that exist in the world today. There is a sizable group of Americans who seem to think that big government is our greatest menace. They still believe, as Jefferson did a century and a half ago, "that government is best which governs least."

In the memory of most of us we have seen the need of a Communications Commission, a Civil Aeronautics Board, a Power Commission, the Securities and Exchange Commission, and many other Government agencies. These are some of the more recent evidences of expansion of national sovereignty. In the world of today, Government, regardless of political party, must grow bigger and more powerful to survive.

It is within the historic, as well as the present economic framework, that the report of the Commission on Money and Credit should be considered. The national goals which the recommendations of the Commission seek are an adequate rate of economic growth, low levels of unemployment, and reasonable price stability.

The Commission believes that national economic policy is an integrated whole and recommendations are made as to how the relationship among monetary, credit, and fiscal measures might be planned, reviewed, and related to other measures at the Presidential level.

The most important aspect of the report is that it recognizes that monetary and credit policy is, of necessity, an essential part of the overall economic national policy and it cannot be successfully used separately. The Commission calls for a much greater degree of coordination in national economic policy which, in effect, means much closer ties between the executive branch of the Government and the Federal Reserve, as well as the other independent agencies. It indicates that too much independence of the Federal Reserve can mean isolation and the Commission recommends a greater measure of coordination. The report does not lessen the power of the Federal Reserve, rather, it makes recommendations that will strengthen its position and enhance its influence in dealing with the President. It also makes some suggestions to strengthen the Nation's private financial system and it recognizes that monetary policy, to be effective, must be supplemented by fiscal and debt management programs.

The Commission has recommended some important and needed changes in the organization and functioning of the Federal Reserve System, as well as in the commercial banking system through which it operates.

LEGISLATIVE MANDATES

One of the most important recommendations made by the Commission is that Congress modernize and make consistent the legislative mandates which set out national economic goals in the two statutes that bear most directly on the field of the Commission's concern; namely, the Federal Reserve Act and the Employment Act of 1946. Identical language should be incorporated simultaneously in each of these statutes to formulate the goals of a low level of unemployment, adequate rate of economic growth, and reasonable price stability. These same goals should be made applicable to all Federal agencies administering economic programs. At the present time the Employment Act does not include stability as one of the goals and the Federal Reserve Act does not contain a provision specifically setting out these objectives.

COORDINATION

In order to bring about the needed coordination to make the mandates effective the Commission recommends that the President consider setting up a council under a chairman to be designated by him and plan its work so that weekly meetings be held of related and interested department and agency deputies, supported by staff assistants from the Council of Economic Advisers. These weekly meetings should culminate in periodic meetings of their chiefs with the President.

MAJOR INSTRUMENTS

The major instruments of general monetary policy are the powers to buy and sell securities in the open market, the power to fix discount rates and regulate conditions of member bank borrowing, and the power to change reserve requirements of member banks within the limits specified by Congress. It is recommended that these powers be confined to the Federal Reserve Board.

DISCOUNT RATE

At the present time discount rates are set by each Federal Reserve bank every 2 weeks by its board of directors, subject to review and approval of the Federal Reserve Board. Credit markets are national in character and regional differences in discount rates are ineffective. Under these circumstances a national discount rate policy should correspond with the national open market policy. It is therefore recommended that a discretionary uniform discount rate be established by the Federal Reserve Board for all Federal reserve banks.

OPEN MARKET

The Commission recommends the continued use of open market operations as the normal and most useful instrument of general monetary policy. Instead of relying on a bills-only policy, the Federal

Reserve should be willing, when domestic and international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varied maturities. However, the normal use of open market operations in bills to carry out technical and seasonal changes in bank reserves is appropriate.

That has been read before by Mr. Wilde.

It is recommended that the present open market committee be abolished and that its functions be placed in the hands of the Board. This would place directly in the Board, a governmental body, the three major general instruments of monetary and credit policy. The open market powers are now vested in the Federal Reserve Board and five of the Reserve bank presidents whose terms on the open market committee rotate with the exception of the president of the New York Federal Reserve Bank whose term is continuous. These members cannot be considered governmental as they are elected by their board of directors, the majority of which are elected by the member banks, whereas the members of the Federal Reserve Board must be appointed by the President and confirmed by the Senate, and make their reports to the Congress.

RESERVE REQUIREMENTS

The present general form of fractional reserve requirements against demand deposits is adequate for the purpose of general monetary policy. However, the Commission recommends that the reserve requirements on demand deposits for all member banks be made the same and the classification of country banks and reserve city banks be eliminated. The central reserve city bank classification is to be abolished under the present laws by mid-1962. The elimination of reserve differentials would provide better control over the money supply than is now possible. The Commission recommends that Congress continue to grant to the Federal Reserve Board a range of from 8 to 18 percent within which reserve requirements can be set for demand deposits. This would give to the Board sufficient flexibility to adjust the level of reserves to meet the needs that may develop.

It is recommended that existing statutory reserve requirements against savings and time deposits be repealed. These are now uniform for all member banks and provide a range of from 3 to 6 percent. These rates are significantly different from those required of competing thrift institutions.

ORGANIZATION OF FEDERAL RESERVE

The Commission recommends that the Federal Reserve Board be reduced to five members with overlapping 10-year terms, one expiring each odd-numbered year, members to be eligible for reappointment. At present the Board consists of seven members of 14-year terms and not eligible for reappointment. The reduction in membership should enhance the status of each member and the 10-year term combines a sufficient protection for independence. I should like to personally suggest either a compulsory retirement of Board members at the age of 70, or an ineligibility for reappointment after age 65.

The occupational and the geographical qualifications for the Board members the Commission recommends be eliminated. Instead, the

statute should stipulate that members be positively qualified by experience or education, competence, and objectivity, commensurate with the increased responsibilities assumed in achieving the national objectives.

It is recommended that the Federal Reserve Board members be compensated at the highest salaries available to appointive officers in the Government.

It is recommended that the Federal Reserve Chairman and Vice Chairman be designated by the President from the Board membership to serve for 4-year terms, coterminous with the President's. I am sure this was the intention of Congress when it passed the Banking Act of 1935 that provided for the 4-year terms. The Chairman and the Vice Chairman, if not reappointed, could continue to serve out their terms as Board members.

It is important that the Chairman of the Federal Reserve Board be acceptable to the President in order that an effective liaison can be maintained. The fact that he is appointed by the head of the administration in power greatly increases and enhances his influence when he sits as the Chairman of the Board along with other top presidential appointees on the coordinating committee.

The Federal Reserve Board Chairman should be chief executive officer of the Board, empowered to handle administrative matters. The law should be clarified to authorize the Board to delegate to the Board committees or the Board members individually, or to senior staff officers of the Board, and of its functions in the administration of its powers in regard to the supervision of the banking structure. Any actions so delegated should be subject to review in the Board's discretion.

FEDERAL ADVISORY COUNCIL

It is recommended that the present Federal Advisory Council be replaced by an advisory council of 12 members appointed by the Board, from nominees presented by the board of directors of the Federal Reserve banks. At least two nominees and not more than one of them from any single sector of the economy should be represented by each bank. The Board should make its selection, one from each district, in such a manner as to secure a council broadly representative of all aspects of the American economy. Council members should serve for 3-year terms and should meet with the Federal Reserve Board at least twice a year.

The channels of outside advice to the Board need broadening and one obstacle to this is the present statutory position of the Federal Advisory Council, one member of which is appointed by each Federal Reserve bank. Custom has confined the membership of the council to commercial bankers.

CONFERENCE OF RESERVE BANK PRESIDENTS

An important internal source of advice should be further recognized and strengthened.

And I might say that is particularly true in proposing that the president be taken off of the open market committee.

The law should formally constitute 12 Reserve bank presidents as a conference of Federal Reserve bank presidents to meet at least four

times a year with the Board, and oftener as the Board finds necessary. In establishing open market policy, discount rate, or serve requirements, the Board should be required to consult with this conference of presidents.

STOCK OF RESERVE BANKS

It is recommended that the capital stock owned by the member banks be retired out of the surplus funds of the Reserve banks which are adequate for that purpose. Instead of stock ownership, membership in the System should be evidenced by a nonearning certificate of a nominal amount, the same for each bank. This change will help meet the criticism that the Federal Reserve banks are privately owned and operated for the benefit of the member banks, while at the same time preserving member bank representation on the Board's regional Reserve banks and branches.

FEDERAL RESERVE REPORTS

The Commission believes that the Federal Reserve Board should follow the general rule that the public should be kept informed with reasonable promptness and in reasonable detail, the reasons for its major policy decisions and actions in order to avoid misunderstanding and misinterpretation. The Commission recognizes that this is a delicate matter and that the timing and substance of such reports must be left up to the good judgment of the Board.

STRENGTHENING THE FEDERAL RESERVE AND COMMERCIAL BANKING SYSTEM

The strength and influence of the Federal Reserve in our economic system is closely related to the strength of the commercial banking system through which it functions. This system has great need of modernization. It has steadily lost ground in relation to other financial institutions during the past 60 years, and especially during the last 10 years. In 1900 it represented 52.9 percent of the assets as compared with 39.5 percent in 1958—I do not have figures since then—whereas the savings and loan institutions increased from 2.6 percent in 1900 to 9.1 percent in 1958. There is great need, in the interests of the economy as a whole, to strengthen both the Federal Reserve and the commercial banking system. To assist in accomplishing this, the Commission recommends:

1. That all insured commercial banks be required to become members of the Federal Reserve System. There are about 6,600 of these banks which are not members. This legislation would be consistent with the Home Loan Bank legislation which requires all insured savings and loan companies to be members of the Home Loan Bank System.

2. That all Federal bank supervisory agencies be unified by transferring to the Federal Reserve System the functions of the Comptroller of the Currency, as well as those of the Federal Deposit Insurance Corporation. This would greatly simplify and strengthen the examining, regulatory, and supervisory functions of the three agencies. For a complete discussion of this subject and its merits, I refer you to the 1938 Annual Report of the Federal Reserve Board.

3. That the competitive relationship between the commercial banks and the thrift institutions be improved by providing for greater tax equality.

There are other recommended changes which would improve the entire banking system and which will be discussed by others. An especially important one, of course, is the branch bank proposal recommended.

In conclusion, I wish to place in the record my comments and reservations which have been made a part of the Commission's report.

Chairman PATMAN. Without objection, it is so ordered.

Mr. ECCLES. Shall I read it?

In general, I subscribe to the recommendations of the report. However, I have grave doubts that they will prove adequate to achieve the national economic goals which they seek, which are: an adequate rate of economic growth, low levels of unemployment, and reasonable price stability.

The special weakness of the report is that it fails to give adequate consideration and weight to the unstabilizing effects of the monopolistic power exercised by organized labor. It is unrealistic to gloss over the effects of its actions on prices, imports, exports, employment, rate of growth, and the deficiency in our international balance of payments.

Wages and fringe benefits of union labor in this country are from two to five times that of other industrial countries. Thus, organized labor not only draws from the economy benefits in excess of increases productivity, but undermines our ability to compete in world as well as domestic markets.

Until the Government recognizes the seriousness of this situation and passes legislation which adequately deals with it, as it has with business, there is, in my opinion, little chance of meeting the national economic goals.

I think the report is also weak in not dealing more realistically with our international balance-of-payments problem in the light of the phenomenal recovery and great increase in productivity of Western Europe and Japan.

I do not believe the United States can continue as the reserve currency country and world banker in the light of its present price structure. It should move as rapidly as possible to transfer this responsibility to an international monetary organization where currency values can be adjusted—upward or downward—over the longer period as the basic need is determined. Our alternatives are: greatly increased productivity and lower prices or tariffs, quotas, embargoes, exchange controls or the discontinuance of present foreign aid and defense policies.

Chairman PATMAN. Thank you very much, Mr. Eccles.

I would like to ask you two or three questions, if I may.

Senator BUSH. Mr. Chairman, would you yield for just one second? I have got to leave and I want to compliment Mr. Eccles on the very comprehensive statement.

It is very, very interesting and certainly, with his long experience in the Federal Reserve System, the committee should value very highly and will, I am sure, your comments about the changes that seem to be necessary.

I agree with most all that you have said. I do not think I quite go along on the recommendation on the chairmanship. But much of the other recommendations make an awful lot of sense.

I have no doubt that Mr. Eccles greatly influenced the thinking of the Commission in connection with its recommendations for the Federal Reserve System.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

You mentioned discount rates. Under the law that can be done now, can it not, Mr. Eccles, because the law says that although the Federal Reserve bank directors will fix a rate every 2 weeks, that the rate was then to be approved—the word "established" is used in the law as it now stands? It is in the law now?

Mr. ECCLES. That is correct.

Chairman PATMAN. In other words, it is the law now?

Mr. ECCLES. This recommendation simplifies it. The Board today indirectly has the power to change the rate. It seems to me that instead of having the Reserve bank boards meet every 2 weeks for the purpose of establishing a discount rate that may go for years without a change, is unnecessary when the Reserve Board could disapprove it and establish the rate they want.

Now, as a practical matter, the discount rate—I know when I was with the Board—was discussed not only with the Board as a whole but also with the Reserve bank presidents, so that they undertook to establish the rate that was more or less agreed upon, and the first bank meeting after the decision was made was the bank that established the rate. The other banks usually followed suit.

There was a case where one bank did not do so and it was instructed by the Board to establish the uniform rate, so that the Board, in effect, does control indirectly the discount rate.

What this recommendation would do would be to make it direct and clear, and the Reserve banks would not have to be submitting a rate every 2 weeks; that is entirely unnecessary.

Chairman PATMAN. I see no reason why it should not be done, but under present law the Board "establishes."

Mr. ECCLES. It is established in the first instance by each bank, and then the Reserve Board approves or disapproves that rate.

Chairman PATMAN. Well, what rate? It could approve any rate?

Mr. ECCLES. That is right, but what I am saying is that the Reserve banks establish the rate that is indicated to them by the Reserve Bank Board.

Chairman PATMAN. Now, then, another question:

The policy has been established—I do not know when it was established—or permitting the 12 presidents of the Federal Reserve banks to meet with, and take part in, the open market committee meetings, instead of just the 5 who are actually bona fide members of that group.

In other words, the Federal Open Market Committee, as you know, by statute, is composed of the seven members of the Federal Reserve Board, and five member presidents—I mean presidents of Federal Reserve banks—four alternate, one continuous as you brought out, the New York Federal Reserve Bank. But instead of having a meeting of just that Federal Reserve Committee, which is set up as an agency of the Government under the 1935 act, meeting by itself, they actually

have these other seven presidents in there, and they participate in discussion.

They use any moral suasion that it is possible for them to use in connection with the discussion of issues that come up. The point I am getting at, Mr. Eccles, do you consider it under the law legal for these extra members, extra presidents of the Federal Reserve banks, to sit in on those meetings?

Mr. ECCLES. I would think so. I can see no harm in it. On the basis of the rotation which is undertaken——

Chairman PATMAN. I know, but was it done when you were there?

Mr. ECCLES. Sometimes we would discuss matters at a presidents' conference when they were in. But as a usual matter——

Chairman PATMAN. An official board?

Mr. ECCLES. Yes, that is right.

As a usual matter they were not present. Only the members were present at a full meeting of the Open Market Committee. I understand now that all of the 12 presidents meet with the Board very often, maybe once a month.

Chairman PATMAN. I understand they meet every time the Federal Open Market Committee meets, every 3 weeks, is it not?

Mr. ECCLES. That is right.

Chairman PATMAN. All the presidents are there?

Mr. ECCLES. That is right.

Chairman PATMAN. In other words, it is 12 to 7, although only 5 of them can vote, the others participate in the proceedings. They engage in debate and do everything else that the members do.

I personally do not look with favor on that, and I just wondered how it came about. It is evidently something that has been brought about since you left.

The other question I wanted to ask you about is the Federal Advisory Council. Why should we have a Federal Advisory Council, when—I know you have brought it out a number of times, and especially in your book, "Beckoning Frontiers"—the only reason that the Federal Advisory Council was established in the first place was because Mr. Woodrow Wilson, the President, was determined that bankers should not be on policymaking boards?

Mr. ECCLES. That is right.

Chairman PATMAN. And he would not permit any provision to go into a law that would permit the bankers to participate directly or indirectly in the making of, or agreeing upon, interest rates or formulating policies leading to the money supply.

His answer was that it would be just as well to have presidents of railroads on the Interstate Commerce Commission. He was so adamant on that question that I believe Mr. Carter Glass got up this amendment, so that instead of having them on the Board or on these boards fixing interest rates and money supply, they would have the privilege of selecting one from each Federal Reserve district to be on a Federal Advisory Council, which would meet once every 4 months or three or four times a year, and the Board was to confer with them from time to time. It does not say that they would have to do anything more than "confer" with them.

But since that was done, Mr. Eccles, we have changed the whole concept, and we have, in effect, put bankers on the Board itself by

putting people who are selected by representatives of the banks on the Federal Open Market Committee. Why should we have this Federal Advisory Council at all?

Mr. ECCLES. The Commission recommends that the Federal Advisory Council be eliminated.

I think that it was a compromise that was made at the time the Federal Reserve Act was originally passed. I think it would be much better to have a council that was more broadly representative of the interests of the economy rather than the council being made up entirely of 12 commercial bankers. The commercial bankers during my experience in Washington made recommendations to the Board after spending a day together among themselves and with the staff.

I could never figure that we got advice that was completely objective. It always seemed to me that the advice that we got, at least from the majority of the Council, largely favored the private banker point of view rather than what may be considered a public point of view, and possibly the Council were carrying out what they felt was their obligation to represent the private banker point of view with the Board.

I believe the Council has outlived its usefulness.

I believe that a representative group—that does not mean it would exclude all bankers from this body——

Chairman PATMAN. I notice. That is an improvement, I will admit.

Mr. ECCLES. That this body would be widely representative of the interests of the economy as a whole.

Chairman PATMAN. Yes, sir. Now, one other question and I will yield to Senator Douglas. Where in the Federal Reserve Act does the Federal Reserve Board or the Open Market Committee or the Federal Reserve System, or any part thereof, have the duty, obligation, and the privilege of determining monetary policy?

Mr. ECCLES. You mean where in the act?

Chairman PATMAN. Yes, sir.

Mr. ECCLES. I cannot refer you to the section, but, as I recall, the Open Market Committee, as it is now established, was set up in the Banking Act of 1935.

Chairman PATMAN. I believe 1933, made up all the Governors.

Mr. ECCLES. I know, but as it is now established.

Chairman PATMAN. As now established, yes, sir.

Mr. ECCLES. The act of 1935.

Chairman PATMAN. Yes, sir.

Mr. ECCLES. Changed the act.

Chairman PATMAN. Yes, sir.

Mr. ECCLES. And as the bill passed the House, it included only, as I recall, the Board.

The Senate changed the bill to give representation to the Federal Reserve Bank Governors—they were governors in those days—and the act changed them to be presidents.

The conference committee of the House and the Senate reported out the bill that made up the structure of the Open Market Committee, the Board and five members representing the banks.

There was a later modification to that that provided that the New York bank would be continuously on the Open Market Committee, the reason being that was the money market, and the New York bank was the agent for the System in the carrying out of open market policy, and I think that is still the law.

Chairman PATMAN. Yes, sir; since 1942, I think.

Mr. ECCLES. That is right.

Now, the power to change the discount rate, open market policy and reserve requirements were added to the act, but the objectives of monetary policy were not changed. They were practically what they have always been, and I suppose you could read in the act, along with the Employment Act——

Chairman PATMAN. That is the point, I believe: That the Employment Act implements the Federal Reserve.

Mr. ECCLES. That is right.

It implements it in the field of production and employment.

Chairman PATMAN. Yes, sir.

Mr. ECCLES. And not stability. The Federal Reserve Act was rather narrow in the objectives that it gave to the Board. The elastic currency was a matter of first consideration, to provide adequate credit for commerce, agriculture and industry. The broader approach of using it as the economic instrument for maintaining production, employment and an adequate rate of growth was not a concept of the Federal Reserve Act at that time.

In the Banking Act of 1935, the mandate, a good deal like the one that is now proposed, was in the House bill, and that had to be sacrificed in the negotiations in conference. That was prior to the Employment Act.

Chairman PATMAN. It should be said, Mr. Eccles, I happen to remember this, and you were in favor of the Federal Reserve Open Market Committee being made up of public members only.

Mr. ECCLES. Yes, sir.

Chairman PATMAN. And your opinion prevailed in the House committee.

Mr. ECCLES. That is right, and the objective is the same that is now proposed.

Chairman PATMAN. It was in the Senate committee that the representatives of the bank were put on and in the conference that was agreed to. I well remember that. I have read your book with great interest, and you recite a lot of these things and how they came about, and I think you rendered a great public service when you wrote that book.

Senator Douglas?

Senator DOUGLAS. Mr. Eccles, in your statement you declare:

> I am sure this was the intention of Congress when it passed the Banking Act of 1935 that provided for the 4-year terms—

namely, that the Chairman and Vice Chairman of the Federal Reserve be designated by the President on the Board membership, and that the term should be coterminous with that of the President.

Now, why you did not become a member of the Federal Reserve Board until 1936, it is my memory that you were special assistant to the Secretary of the Treasury in 1934 and 1935?

Mr. ECCLES. No, no.

Senator DOUGLAS. Pardon?

Mr. ECCLES. I became the Governor of the Federal Reserve Board in the fall of 1934, and I took the appointment with an understanding with the President that he would support what proved to be title II of the Banking Act of 1935, which called for these basic reforms in the Federal Reserve.

Senator DOUGLAS. What I am trying to do is to establish your competence in this matter. I am simply trying to establish your competence, speaking about the Banking Act of 1935, because you had a great deal to do with the preparation, administration, and draft, and were in intimate touch with the development of that bill as it went through Congress, is that not true?

Mr. ECCLES. That is correct.

I had a great deal to do with title II of the act. There were three titles. Title I dealt with some amendments to the Banking Act that was favored by the Comptroller of the Currency. Title II dealt with the Federal Reserve; and title III, the Federal Deposit Insurance.

The purpose for getting title II sandwiched between titles I and III was to get some assurance of its passage; that the banking fraternity wanted very much to have title I and title III. They were very much opposed to title II. The way to get title II was to tie them into title I and title III.

Senator DOUGLAS. You say that it was the intention of title II to provide that the terms of the Chairman and Vice Chairman would be coterminous with that of the President?

Mr. ECCLES. I think so.

The bill was modified in the conference committee. It was late in the session of Congress. The House bill provided that the Governor of the Board serve at the pleasure of the President. Up to this time, the Secretary of the Treasury had always been the Chairman of the Federal Reserve Board, ex officio Chairman.

The Comptroller of the Currency was also an ex efficio member, and there were six members of the Board appointed for 12 years, their terms alternating. This made a Board of eight.

The Governor, one of those eight members, was designated by the President to serve as the chief operating officer of the Board. He was known as the Governor of the Board. I was appointed to that position in the fall of 1934 when Congress was not in session.

The law, although it did not specify that the Governor should be appointed to serve at the President's pleasure, it was always interpreted to be the case, because it did not provide for any term. It said:

> The President shall designate one of the members of the Board to serve as Governor.

Up until the term of Eugene Meyer, who Mr. Hoover appointed in 1928, the President appointed the Governor of the Board who was chief operating officer every year, from the beginning of the System.

You had until the Banking Act of 1935 the Secretary of the Treasury, the Comptroller of the Currency and the Governor of the Federal Reserve Board appointed to serve at the pleasure of the President.

You must admit from that organizational structure then was much less independent than after the Banking Act of 1935. The Banking

Act of 1935 created a much greater degree of independence than existed prior to that time.

Senator DOUGLAS. How did this lack of synchronization between the terms of the Chairman and the Vice Chairman at the present time develop? The term of the Chairman was to be for 4 years. You said it was the original intention that the term should run in terms of the presidency but in practice this has not happened.

How did this failure to develop synchronization of terms come about?

Mr. ECCLES. The Banking Act of 1935 went into effect as of February 1936. If that was a presidential year, then the President would be sworn in, in January, and the Chairman would be appointed as of the 1st of February.

To the extent that this was not the case, it would not be coterminous. If a Chairman should resign, as was the case of Chairman McCabe, before his term expired, a new Chairman appointed for a term of 4 years, that would not be coterminous.

Senator DOUGLAS. Was it synchronous up until the resignation of Chairman McCabe?

Mr. ECCLES. I could not say. Let us see, 1936, was that a presidential year?

Senator DOUGLAS. It certainly was.

Mr. ECCLES. Yes. You were elected that year, I think.

Senator DOUGLAS. No, No. I am not as antique as that.

Mr. ECCLES. No, no, it was in 1946. You were 10 years younger than that.

I tell you—I think it must have been—it must have been a presidential because I went in as Chairman on the 1st of February 1936, and I continued to serve as Chairman for a period of 12 years. Mr. Truman went in as President in 1945. I was appointed for a term of 4 years in the 1st of February.

Senator DOUGLAS. Of 1944?

Mr. ECCLES. 1944, that is right, so it was synchronized.

Senator DOUGLAS. Of course, it is not quite synchronized, because, if your statement is correct, it would be the last year of an outgoing President rather than the first year of an incoming President.

Mr. ECCLES. Mr. Roosevelt had just gone in, in 1944, in January.

Senator DOUGLAS. Yes, that is right.

No, he was elected in November 1944.

Mr. ECCLES. All right. I am not sure.

Senator DOUGLAS. Would you be willing to read the transcript and then get the chronology corrected for the record?

Mr. Roosevelt was elected November 1944 and took office January 1945.

Mr. ECCLES. Right.

Senator DOUGLAS. Now, if I may go into a somewhat painful matter, but which perhaps the passage of time has smoothed, in 1948 you were replaced as Chairman by Mr. McCabe. This was a result of your resignation?

Mr. ECCLES. No, I offered my resignation to President Truman when he was elected.

Senator DOUGLAS. When he was elected?

Mr. ECCLES. That is right—I mean when he took the Presidency.

Senator DOUGLAS. I understand.

Mr. ECCLES. And he was not willing to accept it, wanted me to stay.

Senator DOUGLAS. That is, you felt that the incoming President had the right——

Mr. ECCLES. I did.

Senator DOUGLAS. To name the new Chairman of the Federal Reserve Board and that you were not to hold over automatically because you had been appointed?

Mr. ECCLES. I felt very strongly that I should offer my resignation as he did not appoint me, and he should select somebody of his own choosing.

At the end of my term as Chairman February 1, 1948, I was not redesignated. I chose to continue to stay on as a member of the Board, which, of course, I had a right to do. Does that answer your question?

Senator DOUGLAS. I think it establishes, subject to correction of the record, it establishes the fact that up until 1952, was it, that the President had the right to name the incoming Chairman at approximately the time hat he came into office?

Did you offer your resignation to President Roosevelt in 1940? Did you have any conversations with him about that matter?

Mr. ECCLES. I took the 4-year term when the new law was passed so that my term as a member and my term as Chairman expired at the same time, and I wanted to leave Washington. I had planned to leave. I had served as long as I felt that I should, and I wanted to leave Washington, and he persuaded me to stay.

Then I took another 4-year term instead of the 14-year term.

Chester Davis, who was a member of the Board and who wanted to have the long term, he resigned from the short term and got a 14-year term, and I took his unexpired 4-year term so that my term as a member expired coterminous with that of my chairmanship.

Senator DOUGLAS. So that in practice you carried out the principle——

Mr. ECCLES. One of my reasons for that was I had been extensively engaged in the banking business and I wanted to go back into it, if that would permit me to do so.

Senator DOUGLAS. Then it was your practice, as well as your belief, during the period that you were on the Board that the incoming President should have the right to replace you, if he so desired?

Mr. ECCLES. That is right.

As a matter of fact, I said before to the House in 1935:

> I think, as a practical matter, it is reasonable to allow the President to remove a Governor when he sees fit. An administration is charged with the economic and social problems of the Nation. It seems to me to be extremely difficult for an administration to deal with these problems, economic and social of the entire country, without having these powers. There must be a liaison, a responsive relationship between the administration and the monetary system. This does not mean political control in the undesirable sense which it is often implied. I think that the Governor of the Federal Reserve Board is the channel through which the relationship with the Federal Reserve System should develop.

That is 26 years ago.

Senator DOUGLAS. It was of great benefit to the country, Mr. Eccles, that you were not permitted to go back to your banking business, although I understand you have done quite well since you did go back.

Mr. Pell?

Senator PELL. No questions.

Senator DOUGLAS. Mr. Reuss?

Representative REUSS. You and the Commission on Money and Credit, Mr. Eccles, recommend that the Federal Advisory Council to the Federal Reserve Board be composed of 12 members, and the Board of Governors of the Federal Reserve should make its selection, one member of the Federal Advisory Council from each district, in such a manner as to secure a council broadly representative of all aspects of the American economy.

Mr. ECCLES. That is right.

Representative REUSS. I am reading from your recommendation on that.

I have this difficulty with that proposal. As I read it, the Federal Reserve Board is restricted to the nominations made by the board of directors of each of the 12 Federal Reserve banks. The banks are not required to nominate people which, in the totality, represent broadly all aspects of the American economy.

Therefore, what assurance is there that the Federal Reserve Board itself will have a slate adequate to insure the choice of 12 who are, in fact, so representative?

Mr. ECCLES. It certainly was the intention of the commission, and in the final drafting of the report in detail, each member of the commission did not have the time or the opportunity to edit it, but I am sure that the intention of the commission was that each of the 12 Reserve banks would select two people.

The idea was that in selecting those two they should not be bankers. I mean that certainly was the intention. And with the 12 banks doing that. So, for the purpose of the Board being able to select 12 out of 24, that would be representative, that is the implication.

I admit if legislation were passed it should be clarified. I agree with you that this language does not do justice to the intention of the commission, as I recall the discussion.

Representative REUSS. I am glad to hear you say that, and I take it, then, it is your view that the Federal Advisory Council should be broadly representative of all aspects of the American economy, and if the nominations, for example, unduly stressed, let us say, industry and commerce to the neglect, let us say, of agriculture, labor and the consumer, you would favor some legislative device so that the Board could have an adequately representative group to pick from?

Mr. ECCLES. I would.

I think that was the intention.

Representative REUSS. Let me turn now to the recommendations of the commission that the Board itself determine open market policies, rediscount rates and reserve requirements, that it be uniform for all three.

I certainly agree with what the Commission on Money and Credit was trying to do there. I would, however, raise this question.

You said in an earlier recommendation that the Board in Washington should meet at least four times a year with the 12 Federal Reserve bank presidents.

Mr. ECCLES. A statutory council of presidents.

Representative REUSS. Yes.

That seems to me a very worthwhile recommendation which we ought to examine very carefully.

I wonder, however, if, having done that, it really is necessary to require that every little open market operation—the same applies in slightly less degree to changes in rediscount rates and reserve requirements—has to be arrived at in consultation with the council of the 12 Reserve bank presidents.

I wonder, in short, whether——

Mr. ECCLES. I do not believe it could be interpreted in that light. It is a question of open market policy which you are discussing, not the day-to-day operation. The matter of policy would be a question, for instance, of purchasing intermediate or long-term governments, whereas bills had been the policy.

That would be a policy matter.

Also, the question of what would seem to be the adequate amount of free reserves that should be in the banking system, whether they should be as high as a billion or whether they should be 500 million or maybe 100 million. In other words, it is not the day-to-day operation.

It would deal with the policy questions of whether money was easy enough with 500 million, or whether it was too easy with 500 million of free reserves.

Now, the day-to-day operations are a matter, of course, that even the Board members themselves don't discuss every day.

Representative REUSS. Let us leave aside these day-to-day operations. Even as to policy questions; I wonder if we are not imposing too much of a consultative burden on the Board when we say that they have got to have four meetings a year with the Council of Reserve Bank presidents, and, in addition, consult with them as a mandatory matter on all open market, reserve requirement, and rediscount policy matters.

Would it not be enough, for example, to, say, have four or six meetings a year and let it go at that? I am just wondering if you are not setting up an administrative straitjacket here.

Mr. ECCLES. I do not believe you are. I think, based on my own experience, I would certainly desire to call upon the Reserve bank presidents for a discussion before changing policy with reference to open market policy or discounts or change of reserve requirements.

I think they are of such national importance, it is very important that the president of your 12 banks be fully informed. They can be very helpful if they know the background, if they know what is going on, and if they have had their say. They then would certainly, if they have had opportunity for expression of their views—give much better support than if they did not know what was going on, and they did not have an opportunity to be heard.

They are professional people, the way it has developed. They are career people pretty largely—I think entirely as of the present time—and they are very close to the economic situation in their area, to the credit and the money situation of the area, and I think their advice and their council would be helpful.

I can assure you of this. You would find they are not always in agreement. You would find they have different points of view which are worth while for the Board to get.

Representative REUSS. Thank you.

I have one more question. The commission also recommends that the changing of reserve requirements be put into 8 to 18 category, and that the present dichotomy between Reserve city banks and country banks be ended.

I have this question. I take it that the two great differences between the use of open-market policy and the use of a change in reserve requirements to affect the level of reserves are that:

(1) When you are expanding reserves and you do it by lowering reserve requirements rather than by buying securities in the open market, you thereby give the banking system 100 percent of the benefit of the added reserves from the standpoint of earning assets rather than 87 or 88 percent.

(2) And the second differences, as I see it, is that if you want to make a tremendous difference in the credit creating powers of the banks, it may be easier to do it by a massive change in reserve requirements rather than by open-market policy, although I am not sure of that second.

Would you agree as a preliminary matter that those are the two major distingiushing features of the reserve requirement change method, on the one hand, and the open-market method, on the other hand?

Mr. ECCLES. I would like to add this to what you have said.

The change of reserve requirements applies to every bank across the board, whether they need reserves or they do not need reserves, whether they may be in an easy position or not. It is across the board that the action is taken. It is what I choose to call more of a shotgun method to get quick action. To reduce reserve requirements, even one-half of 1 percent, would put over the night into the banking system a very substantial amount of excess reserves.

There is no indication that in many banks those reserves would be immediately used. It is a slower process in getting their use of that volume of excess reserves.

One of the difficulties is, to lower reserve requirements is a very easy thing to do and a very pleasant thing for the banking system. It increases their earning capacity. It frees balances with the Reserve banks upon which they get no return.

To increase reserve requirements is pretty drastic. It would tighten the situation too rapidly, and I think that it is very difficult to increase reserve requirements unless we had an unusual situation.

At the time we got these powers, the Banking Act of 1935, it was primarily to absorb the huge amount of excess reserves that were in the banking system because of the very large gold inflow. We had something like 7 billion of excess reserves as a result of the gold inflow due to our devaluation, in part. In order for the central bank to get close enough to the money market to have any influence at all, it had to be in the position where free reserves were much lower. It is a standby power that the Reserve System should continue to have.

It is a power, however, that should be used very sparingly, in my opinion.

The open market operation is very flexible. It puts reserves immediately into the money market in the amounts desired. It has a close relationship to Treasury financing. Through open market policy rates on Government securities can be influenced. This was done last

fall at the time this country was having large losses of gold—by buying intermediate and longer term bonds and selling Treasury bills and certificates. The effect was to reduce the intermediate and possibly, to some extent, the rates on longer term securities and to increase the rate on bills and certificates.

Certainly it increased the amount of bills in the market and tended to reduce the amount of intermediate or longer bonds by reason of the purchase, and I think may have had some temporary psychological effect.

Representative REUSS. I thank you for your excellent summary of the differences in technique and effects of changing the reserves via the reserve requirement route and via the open market route, and now I would like to ask my question based on this, although I think I may be trespassing.

Senator DOUGLAS. No, no, please go ahead.

Representative REUSS. My question is this:

If you sort out the various elements that are involved in the judgment as to whether you use reserve requirements or open market policy to change reserves, it seems to me that you come up with this:

That the use of reserve requirements on the upside to diminish reserves is a very drastic sort of a piece of machinery to be used only in relatively anusual situations or circumstances. On the downside, to increase reserves, it involves, very largely, a choice as to the level of bank earnings, on the one hand, and as to the burden on the taxpayer through the carrying of the national debt, on the other hand.

I am wondering if this latter set of value judgments is not a set of judgments that ought perhaps to be made by Congress over at least the intermediate period for 5-year or 10-year periods, based upon congressional judgments as to the burden of the interest rate on the national debt.

If this were done, it might be that the limits within which the Federal Reserve Board might change reserve requirements would be rather narrowly circumscribed or even the level itself stipulated in the act of Congress, leaving to the Federal Reserve the power to change those for extraordinary reasons. As it is now, the vital question of bank earnings and burden to the taxpayer on the carrying charges of the national debt, which ought to be, I should think, high-level, fully debated considerations, gets decided in a somewhat offhand way. I am wondering, therefore, whether it would not be in the public interest to narrow somewhat the range of reserve requirements which may be set by the Federal Reserve, or even have the act of Congress name a flat percentage figure, provided always that where extra circumstances occur, the Federal Reserve Board could change it?

Mr. ECCLES. I would not personally like to see that done. I would like to suggest you consider these factors. In the first place, the present law provides a reserve of 7 percent—this is a statutory requirement—of what is known as country banks. Ten percent is a statutory requirement of Reserve city banks. The central Reserve city bank has gone out of the picture, and it should have gone when the Federal Reserve System was set up.

The Banking Act of 1935 gave to the Board power to double these reserves. That is the limitation.

Now, the Commission sees no reason or justification for having different reserves among different classes of banks.

Representative REUSS. If I may interrupt at that point, I have not really raised that in my discussion. Let us assume that that is a valid recommendation.

Mr. ECCLES. Yes.

I would like to say in that connection Congress passed legislation permitting the vault cash to be counted as reserves of member banks. That gave a special advantage to the smaller banks who have a substantial amount of their reserves in cash in the vault, whereas the Reserve city banks are close to a Federal Reserve bank or branch and carry very little currency.

So it did tend to make for some equalization in that regard.

Representative REUSS. And so the Commission, I gather, felt it is now fair to meld the two categories?

Mr. ECCLES. Yes, I think so. That tends at least to make it more fair, you see.

Representative REUSS. Yes.

Mr. ECCLES. Now, of course, the whole purpose of a reserve banking system is to control the amount of credit that a member bank is able to extend, and the higher the reserve requirement, the harder it is to ease the money situation. In other words, the Federal Reserve would have to buy that many more Government securities. If you have a 20-percent reserve, you get a 5 for 1 leverage. You have a 10-percent reserve, you get a 10 to 1 leverage.

Following the pattern of central banks generally, Canada, England, and other places, they do not require large reserves. The reserve requirement, I think is around 10 percent.

There are situations where a bad inflationary situation developed, because governments have borrowed directly from the Treasury for their financing. In such cases reserves have been as high as 60 percent. That is where you get direct financing for the Treasury, so the borrowing directly from the Reserve banks creates a huge volume of excess reserves. So a high reserve requirement is necessary.

I am familiar with, as I know you are, the theory of 100-percent reserve requirement, and the Government doing all of its financing on a basis of no interest.

There has been a school of thought that said that we should have a 100-percent reserve requirement and the Government would not have to pay any interest. I am not so concerned about the interest that the Government pays. It goes back to the economy as a whole. You look at the ownership of your bonds and you will find they are very widely distributed, and so the interest in widely distributed, and, of course, the Government collects in taxes a substantial amount of the interest where the bonds are held by corporations or banks, for instance.

You have, as I have indicated in my statement, 6,600 banks which are not members of the Federal Reservė System. Certainly, if the reserve requirements are going to be made onerous, those banks would have to be brought into the system or those that are in the system would withdraw.

The higher the reserve requirement went the less likely they would be to stay in.

Representative REUSS. Your commission, of course, recommends that all insured commercial banks be brought in.

Mr. ECCLES. We definitely do.

It may be necessary to cover all uninsured, if you got too high a reserve requirement. They may try to get along without insurance; that is a possibility. There is nothing magic in the 8 to 18 percent. You could make it a minimum of 10 percent and a maximum of 15 or 20.

But I do think that there should be this discretion. I think that to go to Congress, as you people know better than I do, it is a long, drawn-out process to get changes, and if there is going to be an amendment to the act to take all banks of deposit into the system and require reserves to be uniform, I should like to see some leeway between the maximum and the minimum.

Senator DOUGLAS. It is 10 minutes after 1 o'clock. If Mr. Eccles would be willing to return this afternoon at 2:30, or, on the other hand, Congressman Reuss has a question which he wishes to put now.

Representative REUSS. I guess I am the last questioner here and, thus, if Mr. Eccles could bear with me for a couple of minutes more, and I hate to keep the chairman here——

Mr. ECCLES. I will be glad to come this afternoon.

Senator DOUGLAS. That is all right.

Representative REUSS. Let me ask this question:

The present reserve requirements set by the Federal Reserve Board are 12 percent for country banks and 16.5 for city banks. That is where they are today?

Mr. ECCLES. Yes, that is right.

Representative REUSS. Now, let us leave to one side for the moment the question of whether city and country banks should be made identical.

Why would it not be sensible for Congress to provide that reserve requirements shall be, until further legislative change, exactly what they are now; i.e., 12 percent for country banks; 16.5 percent for city banks? Or, if your recommendation for marrying the two were adopted and they reach identity over a period of years, the country banks going up a little, the city banks going down, whatever the formula is, could you not provide that reserve requirements may be shifted to anywhere within the interval between 8 and 18 percent, only when the Federal Reserve Board determines that the method of open market purchases or sales is a less valid method for executive monetary policy?

In other words, I do not see why the Federal Reserve Board should have this power to decide how much the taxpayers have to shell out on the national debt. I should think that it is enough to give the Federal Reserve Board discretion within the field of monetary policy.

Mr. ECCLES. I should like to see whatever reserve requirement is fixed, made uniform. Whether it be 16 percent or 10 percent or 12 percent, it seems to me that it is a misnomer to say country bank and reserve city bank. It goes back to before the Federal Reserve came into being and is a carryover.

There are large cities where the banks are classified as country banks. Newark, Jersey City N.J., and Rochester, N.Y., for instance, and you can find, if you look over the country, many other large cities with big banks classed as country banks.

On the other hand, you have much smaller cities in other areas that are classed reserve bank cities.

And so I would say there should be uniform reserve, whatever rate is fixed. Whether the Congress wants to give the Federal Reserve Board the power to change reserves, of course, is up to them. I would prefer to see some discretion. If the Federal Reserve Board, an agent of the Congress, makes these changes and they cannot justify it, it seems to me that they have got to appear before the committees. They have got to give reasons for their changes. There has certainly got to be justification.

A 16-percent reserve is substantially higher than is carried in most countries, and it seems to me that a lower reserve here will accomplish the same purpose, unless the Government is facing the problem from strictly a standpoint of requiring the Federal Reserve to carry substantially more of the public debt—that is what it amounts to—and the banks carrying less of the public debt.

There is a criticism very often that the banks do not extend credit with the ease that they should; that they charge too high rates.

Well, the higher their reserve requirement, the less funds that they will have to loan, the higher the rates they are likely to charge or the service charges that they are likely to make.

Representative REUSS. Except to the extent that through open market purchases their reserves reach whatever level is required.

You can increase reserve——

Mr. ECCLES. That is right.

But open market purchases, that, of course, would give the banks excess reserves, the open market purchases would, and, to the extent they became free reserves, they would be under pressure to loan those funds, that is true. To the extent that the reserves they carry with the central bank are not, say, excessive reserves, of course, to that extent, the banks would have more funds on which to earn. There is this problem of bank earnings that I would like to call the committee's attention to.

You have a growing economy.

A statement was made this morning that the growth of the money supply should be related to the growth of the economy. If we had the kind of a growth in the economy each year that some seem to think that we should have, or could have, say, 5 percent, and the money supply had to grow to that extent, that would mean that deposits would grow very substantially. That, in turn, means that the capital and the surplus of the banking system should have a very substantial growth.

There has been criticism that the capital and the surplus of the banks is inadequate for many of them in relationship to their deposit liability today, and, of course, with the growth in the money supply, that ratio would get worse instead of better.

Now, there are two ways that a bank can get funds, capital funds. One is retained earnings and the other is go to the capital market.

If they go to the capital market, they have to have substantial earnings and pay dividends. So if it is expected that you are going to have a strong commercial banking system, they are going to have to have earnings in order to either retain earnings for additional reserves and capital, or they are going to have to go to the capital

market for funds, and to do that they are going to have to pay dividends and their stocks have got to be sufficiently attractive to go to the capital market.

I think if you will take the record of the banks over the period of the last 20 years, or even the last 10 years, that the earnings of the commercial banking system were substantially less than that of industry.

Representative REUSS. I have one final question. There is no reason, is there, under a system whereby adequate reserves are created by open market policy, why the banking system may not thereby have sufficiently bountiful earnings so that they may meet their future capital needs?

Mr. ECCLES. Open market policy does not necessarily help earnings. To create excess reserves can lower interest rates very substantially and banks' earnings will be reduced. The banking system during the first 6 months of this year, practically all of them had a reduction in earnings, and even though they had, the banking system, as a whole, had 500 million of free reserves.

Representative REUSS. Most of which were created, however, by the action of the Federal Reserve in counting vault cash?

Mr. ECCLES. They were all created by action of the Federal Reserve.

My point is merely by having free reserves does not help the earnings of the bank. It does the reverse. It drops the interest rate to a very substantial extent. There was a time when the banks had seven billion of excess reserves and the interest rate on Treasury bills was zero. So that merely excess reserves does not improve the earnings of the commercial banking system.

It tends to put them under pressure to loan. It creates a favorable climate for the extension of credit at lower rates. That is what it does.

Representative RUESS. This is an extremely interesting subject, but I have already trespassed longer on our time than I should have.

I might conclude by asking you to do this, Mr. Eccles. If, when you read the colloquy that we have just been having, and I assume you will have an opportunity to read it, you wish to say anything to enlighten me further on my central point, I would appreciate it. My central point is that it seems to me just as possible for the banks of this country to enjoy adequate earnings under a system whereby reserves are created by open market policy than under a system whereby reserves are created by the lowering of the reserve requirement.

Mr. ECCLES. I do not believe that is true.

Representative REUSS. Would you address yourself, perhaps, in a reply to the question I have asked? I think it would take us unduly long now, but I would appreciate anything that you would care to add on it to disabuse me of what apparently is a misapprehension of how things work.

(The information is as follows:)

Replying to Representative Reuss' comment that it "seems to me just as possible for the banks of this country to enjoy adequate earnings under a system whereby reserves are created by open market policy than under a system whereby reserves are created by the lowering of the reserve requirement," I believe that is true if reserve requirements are low enough to commence with—the reason being that the lower the reserve requirement, the greater the amount of loans and investments the banking system can make.

Creating reserves in the banking system by open market operations enables the banking system, as a whole, to expand credit and deposits by an amount depending upon the reserve requirements. In other words, if reserve requirements were 20 percent of demand deposits, the expansion could be approximately five times that amount.

If the amount of open market purchases by the reserve system were offset by an increase in reserve requirements of a like amount, the banks would lose earning assets to the reserve system by the amount of the increase in reserve requirements.

The reserve system, if it had the power to do so, could increase reserve requirements of the banking system to 100 percent of the banks' commercial deposit liability. To meet this increased requirement, or any portion of it, the banks would have to borrow from or sell earning assets to the reserve system equal to the amount of such increase. This would ultimately leave the banking system with no earning assets except their capital account and the reserve system with all of the remaining earning assets.

The higher the reserve requirements of the banking system, the greater would be the pressure on interest rates and service charges to maintain earnings. The lower the reserve requirements, the greater will be the earning assets of the banking system and the less the pressure on interest rates and service charges.

Senator DOUGLAS. We will meet this afternoon at 2:45 if you will be willing to return.

I would like to complete the record on one point, if I may, and that is the earnings of banks.

The members of the staff have given me a memorandum drawn from the annual reports of the Federal Deposit Insurance Corporation covering the insured commercial banks showing net profits after corporate income taxes per $100 of total capital accounts; that is, including capital and preferred stock, surplus, and undivided profits and reserves.

(The information is as follows:)

Year	Percent	Year	Percent	Year	Percent
1941	6.72	1948	7.49	1955	7.90
1942	6.34	1949	7.98	1956	7.82
1943	8.82	1950	8.51	1957	8.30
1944	9.73	1951	7.82	1958	9.60
1945	10.87	1952	8.07	1959	7.94
1946	10.01	1953	7.93	1960	10.03
1947	8.20	1954	9.50		

For 1960 this indicates profits prior to taxes, something over 20 percent.

Mr. ECCLES. Yes.

Last year was a high earning year because of your very high interest rate. You had a tight money policy last year, and, if you will recall, the Treasury bills got up to 4.5 percent and the general loan rate was high, not because the banks fixed the rates, but because the demand for money exceeded the supply when there was no growth in the supply because of Federal Reserve policy.

Senator DOUGLAS. Thank you very much.

We appreciate your willingness to come back.

(Whereupon, at 1:25 p.m., the hearing was adjourned, to reconvene at 2:45 p.m., of the same day.)

AFTERNOON SESSION

Chairman PATMAN (presiding). The committee will please come to order.

Governor Szymczak, please. We have as our first witness Mr. M. S. Szymczak, who was a member of the Board of Governors of the Federal Reserve System, I believe longer than any person in history.

I think you were a member 30 years, is that correct, Governor Szymczak?

STATEMENT OF MATT S. SZYMCZAK, CONSULTANT TO C. J. DEVINE & CO., NEW YORK, CONSULTANT TO THE PRESIDENT OF GEORGETOWN UNIVERSITY

Mr. SZYMCZAK. Thank you, Mr. Chairman, 28.

Chairman PATMAN. We are glad to have you with us, sir. I understand you have a prepared statement so you may proceed in any way you desire.

Mr. SZYMCZAK. Thank you, Mr. Chairman.

I would like to thank Congressman Wright Patman, chairman of the Joint Economic Committee, and Senator Paul Douglas, its vice chairman, and all the members of this committee for the invitation to testify—to give my views on the recommendations which the Commission on Money and Credit has made with respect to the Federal Reserve System. The purpose of this committee's work is excellent and the patience, time, and energy devoted to your challenge deserves sincere and high praise not only from the public but especially from Government officials. Your work is in an area where so many contrary theories prevail and where so many high authorities in business, education, and government express a rather large variety of views with positive knowledge gained from theory and practice. Ever since you have come into operation, economic knowledge among the public has increased at all levels. The public, the student, the teacher, and the lawmaker benefit from the material you compile and present.

The Commission on Money and Credit, its chairman, Mr. Frazar B. Wilde, and those who gave of their funds for the study and its staff and experts are to be praised for what they did. They did it well. I was particularly pleased to see that my close friend and former colleague, Chairman Marriner S. Eccles, is a member of the Commission. His experience and dedication are invaluable. I am glad he is here today.

Let me here say "thank you" to Bertrand Fox, research director, and Eli Shapiro, deputy research director. It must have been a very difficult job to compile this report. This becomes evident through the memorandums of comment, reservation, or dissent which appear in the report as footnotes. Let's not neglect to say that this report is a very good step forward. It shows work and promises that answers must and will be found; some now and some later.

It goes into areas where it is next to impossible to be immediately specific, and satisfy everybody, regardless of where he stands. That I do know. As the chairman of the Commission, Mr. Frazar B. Wilde, expresses it, this study should be read by as many Americans

as possible so that more of the American people will get a better knowledge of the "important and vital complementary role of Government in helping a relatively free society to do a better job."

I understand you wish me to address my remarks to the structural changes in the Federal Reserve System recommended—I shall do so briefly in this paper, but I also shall be glad to answer questions on these and other related recommendations in the report—today or at any time in the future.

1. The Commission recommends that all insured banks should be required to become members of the Federal Reserve System. This question of membership is not new, as you know. The "Fed" and Congress have wrestled with this for years, even long before the FDIC.

Let me state at the beginning that I, too, think that the problem of membership or nonmembership in the system, i.e., the scope and thus potential effectiveness of monetary control, should be solved as soon as possible.

The question is mostly a matter of equity, and here are the reasons:

(a) Figures prove what has been indicated in the Commission report, the relative amount of deposits under the control of the monetary authority has decreased; and while the number of insured commercial banks has increased over the period under observation, the number of member banks has decreased.

The figures are:

	December 1947	Percent	December 1960	Per cent
Total deposits held by commercial banks:				
All commercial banks	144,102	100	229,844	100
Member banks	122,528	85	193,029	84
Nonmember, insured	19,340	13	35,391	15
Nonmember, noninsured	2,251		1,443	

Why have banks left the Federal Reserve System? The main reason is because of the reserve requirements they are obliged to hold with their respective Reserve bank. These requirements are at present 16.5 percent of net demand deposits for central Reserve city and Reserve city banks and 12 percent for country banks.

The present legal requirements can cover a range of: 10 percent—22 percent for central Reserve city and Reserve city banks, and 7 percent—14 percent for country banks.

In effect, this means that member banks have to keep more or less substantial amounts of their net demand deposits idle. For a bank which operates on narrow margins this means considerable hardship. It is common knowledge that there is a trend among depositors to shift excess funds from noninterest bearing demand deposits to time or savings deposits. Thus commercial banks lose demand deposits, and, in addition, reserve requirements freeze additional amounts of deposits. Now, as the Commission points out, reserve requirements for nonmember banks are established by most States and frequently are lower than requirements imposed on members. Various States permit State-banks to count balances with correspondence as legal required reserve. Thus nonmembership is given a competitive ad-

vantage. Some count holdings of Governments as part of required reserve.

Looking at the problem from this angle a second reason offers itself as to why the present setup should be revised, namely, that of equal treatment under law. National banks are compelled by law to join the Federal Reserve System, and, thus, the law makes them subject to reserve requirements. All other commercial banks do not have to join, thus are not subject to the "Fed's" reserve requirements and thus are granted by law a competitive advantage.

Three proposals are made:

1. To require all commercial banks to become members of the Federol Reserve System, or
2. To require all banks wanting insured status under the Federal Deposit Insurance Corporation to become members of the Federal Reserve System, or
3. To require that all commercial banks, whether members or not, be subject to similar reserve requirements both with respect to quantity and form while permitting the present right to nonmembership.

I agree with the Commission that attacking the problem at the reserve requirement angle would overcome the principal potential inducement for present members to withdraw and thus also the slippage in monetary control no matter how fractional it may be.

The recommendation of the Commission is that all insured commercial banks should be required to become members of the Federal Reserve System. I feel that they should not be required to become members, but rather I feel that it should be made more attractive for commercial banks to join the System. Another obstacle to joining the System is the requirement that member banks cash checks at par. It is my conviction that the advantages offered by membership in the System are great enough to induce banks to join. The Federal Reserve System does not need to compel anybody to become a member. Nevertheless, I do favor the proposal that all insured commercial banks—and who thus have benefits ensuing from the Federal Government—become members of the Federal Reserve System. Handling the problem this way would eliminate unequal treatment of the different groups of commercial banks.

2. And, of course, I favor uniform reserve requirements—for central Reserve city, Reserve city and country banks—whether at the present legal figure of 10 percent to 22 percent for central Reserve city banks and 7 percent to 14 percent for country banks which might bring the requirements for all classes of banks from about 10 percent to 20 percent, or from about 8 percent to about 16 percent, or to a somewhat, but not too much, reduced figure. I would not remove reserve requirements on time and savings deposits. They are too close to money and are frequently demand deposits in effect.

For a long time, I preferred a more scientific system of required reserves and so stated at Board discussions. I learned from the able discussions that it was impractical to do so without creating difficulties of administration in the application of the scientific system to the deposits and the banks. It would become cumbersome and would create problems of administration and procedures in the banks themselves. Reserve requirements originally were set up in law as safety reserves, but subsequently Congress made reserve requirements an instrument of monetary policy.

To distinguish between large banks and small banks on the basis of equity and safety revises the congressional concept of monetary instruments. I learned this point after many years of attempting to provide a more scientific approach in the application of the instrument to types and character of deposits and also in an attempt to place more of the responsibility for freezing reserves on the larger banking institutions and less on the smaller banking institutions. Perhaps some day this will become possible. It is not here now, in my opinion.

3. In a number of other recommendations, the Commission proposed changes in the bodies directly determining monetary policy. Among others, it is proposed that:

(a) The determination of open market policies should be vested in the Board. In establishing its open market policy the Board should be required to consult with the 12 Federal Reserve bank presidents.

As explained in a footnote, the latter recommendation means that—

the present Federal Open Market Committee be abolished and that the functions of the Open Market Committee be placed in the hands of the Federal Reserve Board directly.

As the report points out, the present setup originates in the Banking Act of 1935 when the power over open market operations was officially delegated to the Federal Open Market Committee and when the decisions of the Committee were made binding on all Reserve banks. Previously this had not been the case. Experience in open market operations began on an informal and voluntary basis even before the act of 1935. Now it is the most used instrument because it is so flexible and yet so effective. I feel that the Federal Open Market Committee deserves much credit for this development. The presidents should stay on the Open Market Committee—nothing makes more for a truly effective dedication than actual legal responsibility given by Congress. The Reserve bank presidents bring good information, experience, and judgment from the field. Needless to say, they are experts and they actually take a position, join in the discussion and vote. Taking them off now would, in effect, separate the Board from the Reserve banks. It would be an unfortunate division of the System into Washington and the rest of the System, the Federal Reserve banks; that one is public and the other is private.

The System has a Federal public structure, it is Government, and it is one system. Let us not divide it. A membership of 12 on the Open Market Committee is not too large. A degree of consolidation has been achieved by the provisions of the Banking Act of 1935. The voice of the bank presidents in the Committee is valued highly and very welcome. It is a serious duty which they take seriously and in the public interest. They are able men and I do not feel that they should be taken off the Committee, especially if Congress should see fit to place also discount rates and reserve requirements in the Open Market Committee, and I recommend that—though the commission does not. This would then help, in my opinion, unify and strengthen the System as is the intent of the commission, and, I think, of our Congress.

Further, I am opposed to the proposal to decrease the number of members of the Board of Governors from 7 to 5. The report shows fully the amount of work the Board already has, and the commis-

sion makes proposals which would increase this workload. For example, commenting on the Board's work we read in the report that the exercise of the regulatory powers—

is exceedingly time consuming and will become considerably more so if the commission's recommendation in chapter 6 regarding the consolidation of functions of the Comptroller of the Currency and of the Federal Deposit Insurance Corporation into the Federal Reserve System are adopted.

So we have an increase in power and duties recommended by the commission but a decrease in Board membership.

To come back to the above quote, I think the Board should be relieved by Congress of some of its present bank supervisory responsibilities.

Let me divert for a minute at this point to speak about the chairmanship of the Board. As the commission recommends, the Chairman's term as Chairman should be 4 years that begin and end with the President's term, and that he in law should be the Board's chief executive officer. There is no real need for either provision. The Chairman already is in effect the chief executive officer of the Board. That the Chairman's term be coterminous with the President's was so intended by the Federal Reserve Act. That the two terms do not coincide now is due to death (President Roosevelt) and retirements (of Board Chairman) which have shifted the Board Chairman's term out of line with presidential terms. Let Congress clarify this, however, if it is necessary to do so, to make it coterminous actually with the President's term.

As you know, each Chairman is different. Marriner S. Eccles, Thomas B. McCabe, and William McChesney Martin are good examples. I worked with each and found each very different from the others. But one thing is true, the Board members must, no matter what the law, give each Chairman those powers that will enable the Board to act efficiently and, in the eyes of the public, as one. Differences between them can be recorded or reviewed before Congress. To delegate by law further assignments to Board members or staff, as recommended in the report, is not needed and might create unnecessary problems for the Chairman. Let each Chairman and Board operate as they see fit—but efficiently and in the interest of the economy.

Now, to come back to the number of members on the Board and their work. Efforts should continue by law or by fact to improve coordinated action. More and more conferences with other Government economic agencies become necessary. Workload and responsibilities increase, the number of those carrying the responsibility, however, should not decrease. I agree completely with the Commission that the Board members should have more time to devote "to the broad issues of monetary policy." Putting all these facts together, I cannot really find a reason to decrease the number of Governors.

It has been pointed out by the Commission that the most important characteristic of monetary policy is its becoming effective in a very short period of time. One also is aware of the possible and grave damage wrong measures of monetary policy can do to economic activity. Monetary policy, as we have exercised it since the Treasury-Federal Reserve accord, has very little in common with developments coming about in a more or less automatic fashion. It is more of an art than a science—still. It demands that new decisions be made

from day to day. Under such circumstances, it is good to have the opinion of more than just three or four or even five people.

The Board members must maintain close relations with labor, banks, financial institutions, industry, commerce, agriculture and education. This need is evident to all because to fulfill its functions properly the Board needs ever more and better information. Therefore, Board members have had to travel more often. There is an additional and perhaps even more important factor, namely, the more extensive international relations of the U.S. monetary authority.

As economic ties between us and our Western allies become closer and closer, it will become even more important for Board members to travel abroad; in fact, trips of this kind have already been increased. My point is that with the high probability of Board members being on trips, here or abroad, a Board with a total membership of five simply would not have enough people in Washington to assure proper administration of the country's monetary affairs.

As I say, the System has been working well with a Board of seven, and I do not see any compelling reason why the number should be reduced to five. Again, some Board members might like that but others would not. As a former Board member, I would not, even though many times, like anybody else—tired and bored, listening to everybody else's point of view—I, too, preferred to expedite action if it was in accordance with my point of view.

In view of the ever-increasing responsibilities of the monetary authority and the growing need for Board members to leave the so-called ivory tower more and more often, I feel that the Board of Governors should be kept at its present number of seven.

There are some other recommendations on which I would like to comment briefly:

(*a*) That the bank supervisory functions of the Comptroller of the Currency and of the Federal Deposit Insurance Corporation be consolidated into the Board of Governors of the Federal Reserve System. I do not feel that the Board should be given more bank supervisory responsibilities. As I said before, the burden of responsibilities of this kind is already too great and should be reduced. One should let the Board of Governors concentrate on monetary and credit policy because, if it does not, somebody else will.

If, however, need is seen for a participation of the Board in bank supervision, a solution might be, but I do not recommend it at this time, to place a member of the Board of Governors on the bank supervisory board of the FDIC.

(*b*) That the present form of capital stock of the Federal Reserve banks should be retired and membership in the System be evidence by a nonearning certificate of, say, $500, the same for each bank.

I have testified on this particular question last year. When I testified last year, I said I did not favor it at this time and gave reasons, some of which I mentioned earlier today; namely, reserve requirement, par, cashing of checks, regulations from Washington, and so forth, the unique nature of the System, the burden of membership.

(*c*) I agree with the commission that the true qualifications of the Board members are not the geographic or representation elements stated in the law, but that they should be "positive qualified by experience or education, competence, independence and objectivity."

(*d*) To establish interagency councils is a very good idea. I think they should be formed, and then we should learn by experience what further improvement should or can be made so that coordination of economic actions by agencies will become better and better.

(*e*) The recommendation of the commission that the Federal Reserve should deal in "bills preferably" rather than in "bills only" is something that already is being done by the Federal Open Market Committee. Opinions as to its effectiveness vary with the varying interests, both public and private. I think it is working well but needs more experience and more acceptance by all segments of the market.

(*f*) As to continued efforts to insure uniform standards of discount practices, let me assure the committee that that has been the situation in the Federal Reserve System for a good many years and no doubt will be continued. Each Federal bank reports to the Board and the Board reviews the standards and discusses them with each president.

(*g*) I agree with the commission that salaries of Board members should be at the highest level available for appointive offices in Government.

(*h*) I do not agree with the commission that the advisory council should be replaced by one consisting of 12 members appointed by the Board members in Washington from the nominees presented by the board of directors of the Federal Reserve banks. The present practice affords the Board members opportunity to learn a good deal about the economy, finance and the attitudes and thinking of banks and bankers. Two-thirds of the members of the boards of the Federal Reserve banks are not and should not be bankers. Members of the Board in Washington are public servants.

The present procedure unifies the System in the public interest. Again, the use of and the good derived from the council is different at different times depending largely on the attitudes of the individual Board members and particularly its Chairman. They do not make policy or get advance information, in my opinion, based on my experience.

(*i*) As to eliminating the requirement that gold be held as collateral against Federal Reserve notes and deposit liabilities, I doubt the advisability of Congress' considering the matter of elimination at this time and by itself. A time to consider this matter would be when, for a longer period of time, the deficit in the balance of payments has been reduced and finally changed into a surplus. At the present, I am afraid that it would have psychological effects contrary to those indicated by the commission.

To conclude, then, I would strengthen the Board by strengthening the System as a whole—thus making it a sound and expeditious but clearly unified body. Let us not weaken the Board by weakening its parts or by dividing it into parts—public or political and private or banking self-interest.

This, then, is a rough sketch of my views. I shall be glad to answer questions or join discussions and do such further research as you may request, and come back at any time. I thank you and the commission as well as the staffs.

I shall now discuss the summary of the points made in the longer testimony.

First, I agree that all insured banks should become members of the System.

Second, I agree that uniform reserve requirements on demand deposits at about the present legal figure or slightly, but not much, below it, should be adopted.

Third, however, reserve requirements on time and savings deposits should be retained.

Fourth, I agree that maximum interest rates on time and savings deposits should be on standby basis only. That is, that authority should be in the Board.

Fifth, I do not agree to remove presidents from the Open Market Committee.

Sixth, I am opposed to a decrease of Board members to five from seven.

Seventh, I agree to make the Chairman's term of 4 years coterminous with the President's term.

Eighth, the Chairman already is chief executive officer in fact. Every Board sees to that naturally. If that is spelled out in the law, it would merely clarify a state of affairs already in existence.

Ninth, I do not agree to delegate by law certain assignments to Board members or staff. Let each Board and Chairman operate as is best and most effective. Views should be expressed by each no matter how tiring or boring for others.

Tenth, I am opposed to placing duties of Comptroller of Currency and Federal Deposit Insurance Corporation in the Board. If in opinion of Congress, the Board should participate in formulation of bank supervision policy, Congress can provide a Board member to serve as ex officio member of the Federal Deposit Insurance Corporation Board.

Eleventh, I strongly favor reduction of bank supervisory responsibilities now in the Board—for example, examination, trust powers, bank holding companies, mergers, branches, and so forth.

Twelfth, I would not eliminate member bank stock in Federal Reserve banks at present time. I would do so later when unifying and strengthening of the System is effected by Congress.

Thirteenth, I agree that Board members be appointed on the basis of positive qualifications by experience or education, competence, independence, and objectivity.

Fourteenth, I agree there should be interagency economic councils.

Fifteenth, bills preferably in the open market operations are already here, and I think it will continue to remain here. I will be glad to discuss that later through questions that arise.

Sixteenth, I agree Board member salaries should be at highest level available for appointive offices in Government.

Seventeenth, I do not agree that a change in the advisory council be adopted but suggest consideration by Congress when overall revision of the System takes place to unify and strengthen the System whether member banks should not elect only three directors—all three nonbankers and the Board at Washington to appoint four nonbankers, making a total of seven.

Eighteenth, I do not recommend at this time elimination of 25 percent gold reserve backing to notes and deposits. I suggest consideration of this when we have had a surplus for some time rather than a

deficit in our international balance of payments. I do not know whether I mentioned this or not, but I would recommend that the discount rates, the open market operations, and the reserve requirements be placed in the Open Market Committee.

Nineteenth, as the next step——

Chairman PATMAN. Wait just a minute, Governor. Say that again, please.

Mr. SZYMCZAK. I would recommend that Congress place all discount rates, action on discount rates, all open market operations, and all changes in reserve requirements in the Open Market Committee.

Chairanm PATMAN. As distinguished from the Board?

Mr. SZYMCZAK. That is right, and have the open market continue to remain as it at the present time.

Nineteenth, as a next step to this excellent report of the Commission and to these hearings by the Joint Economic Committee, Congress consider at once giving the President power to appoint a monetary commission consisting of four from Congress, two from the House and two from the Senate, and three from the outside who know but who are not representatives of banking, finance, labor, consumer, or industry. Directive should provide a report in the hands of Congress by March 1962.

Chairman PATMAN. That recommendation of yours that these fundamental powers, important powers, the most important powers of the Federal Reserve Board at the present time be transferred to the Open Market Committee disturbs me very much.

You see, you are acquainted with the history of the act wherein President Woodrow Wilson was determined that people who were selected by the private banks should never be allowed to have anything to say about the supply of money or interest rates.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. I am apprehensive that this would put us back in opposition to President Wilson's views.

Mr. SZYMCZAK. I understand that point.

Chairman PATMAN. And I was in favor of his views, and I agreed with what he said: That it would be just like putting the presidents of railroads on the Interstate Commerce Commission to fix passenger and freight rates. How do you reconcile that? I assume that you would not be in favor of presidents of rairoads being on the Interstate Commerce Commission, would you?

Mr. SZYMCZAK. No, I would not.

Chairman PATMAN. How do you reconcile your advocacy of this?

Mr. SZYMCZAK. With my suggestion that all this be taken as a whole; not in parts.

Chairman PATMAN. Yes, sir.

Mr. SZYMCZAK. If the directors of the Federal Reserve banks elected by the member banks are not bankers.

Chairman PATMAN. Oh, that is right, you have another one in here.

Mr. SZYMCZAK. Yes.

Chairman PATMAN. I had overlooked that. I was not considering it in connection with this. You are recommending that they can select three of their own nonbankers?

Mr. SZYMCZAK. That is right, and four appointed by the Board.

Chairman PATMAN. Suppose they were principal borrowers and had a special interest and an ax to grind?

Mr. SZYMCZAK. That may or may not make a difference. Everybody is a borrower more or less at different times. But the majority would come from the Board, appointment of four by the Board of Governors.

Chairman PATMAN. I had overlooked that. So you are taking this as a package.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. You think it would be a good thing?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. There is another point here I wanted to ask you about. This surplus that the Federal Reserve banks have now, the combined surplus, my recollection is that that has been made up of money that was set aside each year.

Mr. SZYMCZAK. Yes. However, at the present time the surplus is equal to twice the amount of paid-in capital.

Chairman PATMAN. $817 million, something like that?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. But none of that surplus represents original investment of the commercial banks in the stock, is it?

Mr. SZYMCZAK. That is true.

Chairman PATMAN. None of it is?

Mr. SZYMCZAK. I would also recommend that when the whole subject is studied by Congress, that the stock be eliminated.

Chairman PATMAN. Why would you pay it back out of the surplus when none of this stock money went into the surplus?

Mr. SZYMCZAK. I would pay back whatever they paid in.

Chairman PATMAN. I know.

But you would have to pay it in the same way. When it was paid in, it was just absorbed as part of the credit of the Nation and used accordingly. Why should it be paid back that way by just giving them credit and transfer that surplus over to the Treasury and save the taxpayers interest on that much money?

Mr. SZYMCZAK. If you paid back what they had paid in, for which they have a stock certificate, and pay the 6 percent up to the time you pay it back, you give them back what they paid in—period.

Chairman PATMAN. I know, but that should be done in the same way that it was received. When it was received, it was just absorbed and used at the time. It was not put into this surplus fund. I cannot find any trace of it in the surplus fund.

Mr. SZYMCZAK. Originally, it was working capital.

Chairman PATMAN. Yes. A lot of it was used as operating capital in the beginning.

Mr. SZYMCZAK. That is right. But, eventually, it became unnecessary as far as the capital structure.

Chairman PATMAN. Yes. Now, then, you agree with Mr. Martin, I assume, that it is really unnecessary to have capital stock in these 12 banks?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. It is unnecessary to have a surplus?

Mr. SZYMCZAK. As a matter of fact, it is not common stock even now.

Chairman PATMAN. I beg your pardon?

Mr. SZYMCZAK. It is not common stock even now.

Chairman PATMAN. No, it is no part of stock really. It is a misnomer; you agree to that, do you not?

Mr. SZYMCZAK. Oh, yes, definitely.

Chairman PATMAN. It cannot be sold. It cannot be hypothecated. It goes up and down in each bank according to the capital, surplus and undivided profits—no, just capital and surplus, I believe.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. And they get 6 percent on it. That is all they are supposed to get.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. It is not capital stock in the true sense of the word at all?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. One other question about the FDIC. I notice this report recommends that certain functions such as bank examination be transferred to the Federal Reserve. I have been studying this proposal that the FDIC's activities all be abolished except the insurance part only. In other words, a half a dozen people just to administer the insurance only—have nothing to do with chartering of banks. I think that is terrible, the way it works now in practice. A group of investors interested in starting a bank will make application for a Federal charter, a national bank charter, and the Comptroller of the Currency has the sole power to turn that down; that is correct, is it not?

Mr. SZYMCZAK. Yes.

Chairman PATMAN. He turns it down. Then they apply for a State bank charter, and in most States they do not grant them; they have a freeze on or something. They do not grant many bank charters.

As you know, the number of chartered commercial banks has gone down from 31,000 40 years ago to 13,556, I believe it is at the last report. In other words, where we have 43 banks now, we had 100 banks 40 years ago.

The number has gone down because some bankers have discovered how valuable this moneymaking privilege is, and they have begun to act sort of like a dog in the manger, saying, "We want to keep it; we don't want anybody else to have it."

That is the way it worked whether they intended it that way or not. And so they apply to the State for a charter, and if it looked like the State was going to charter it, the Comptroller of Currency can throw off his Comptroller of the Currency hat, put on his FDIC hat and run over to the FDIC Board and block the proposed institution getting insurance. That looks like too much power to me. Do you not agree that that is a lot of power?

Mr. SZYMCZAK. From my experience, Mr. Chairman, I feel that the Board itself has too much responsibility in the bank superivsory field, with the net result that it does not have the time and the energy to devote to monetary policy.

Chairman PATMAN. That is right.

Mr. SZYMCZAK. Especially today.

And to give them also what the Comptroller does and what the FDIC does and then to bring them down to five at the same time, I think, is inconsistent with my experience on the Board. This is some-

thing I have said frequently over and over again at the Board meetings.

I would rather have all of this turned over and as much of what the Board now has to the FDIC, and then, if necessary, to coordinate policy, banking policy, bank supervisory policy, place one of the Board members ex officio on the FDIC Board. In the original consideration of the Federal Deposit Insurance Corporation, there was a provision that the Chairman of the Board of the Federal Reserve was to be an ex officio member of the Federal Deposit Insurance Corporation.

That was dropped subsequently. It did not pass.

Chairman PATMAN. Do you not think that the supervision of the bank should be at one agency like the Federal Reserve?

Mr. SZYMCZAK. I would prefer the Federal Deposit Insurance Corporation to the Federal Reserve.

Chairman PATMAN. In other words, do you not think there is at least some merit in the proposal that they be stripped of all their functions except just the insurance part?

Mr. SZYMCZAK. The Federal Deposit Insurance Corporation should preferably just insure. But since it is the only body that has both National banks and State banks—

Chairman PATMAN. That is right.

Mr. SZYMCZAK (continuing). They are the proper body, much more so than the Federal Reserve, because the Federal Reserve does not have insured banks.

Chairman PATMAN. But they are in conflict with the public interest. You see, the public interest is to have credit; sometimes easy credit, sometimes hard; and unless they are to have easy credit—you see, here is the FDIC and their interest is to keep down any losses. Keep strong banks only; don't run any risk.

Therefore, it is against the public interest, because the public interest contemplates losses now and then, people going broke, trial and error. That is what built this country. Now we are stopping all that and we are saying we have just got to have perfectly solvent banks. They have got to be real careful of what they invest in. They are hard in their supervision, in their examinations. Keep all the bankers scared to death.

I think it is against the public interest myself, and I am going to work on a proposal to strip them of all these powers. I do not know whether I will get any support on it or not. See if we cannot have one supervising, examining agency, just one.

Mr. SZYMCZAK. But not the Federal Reserve Board, I hope.

Chairman PATMAN. That would be all right. I would not object to that, although they are pretty tough.

Mr. SZYMCZAK. The trouble there is that they are already overworked with so many details. I sat at those meetings day after day, day after day, when we were considering mergers, bank holding companies, examinations, and all these things that keep coming up.

By the time we would get around to monetary policies, we were so tired and worn. And if the Federal Reserve does not take care of monetary policy, somebody else will. It will be the Federal Advisory Council or the Treasury or some interagency group that will take over monetary policy. Somebody has to tend to that.

Chairman PATMAN. Mr. Reuss, would you like to ask some questions.

Representative REUSS. Just a couple.

I see your point, Mr. Szymczak, about the seeming inconsistency of, with one breath, saying, let's load all the bank supervisory functions on the "Fed," and, with the other, saying, let's reduce its members from 7 to 5.

Mr. SZYMCZAK. That is correct.

Representative REUSS. However, let us assume that under some statutory reshuffling of functions, bank supervision is centralized in an agency other than the Federal Reserve and is taken out of the Federal Reserve.

Whether this is the FDIC, the Comptroller, or some third agency, we can leave to one side for the moment.

Mr. SZYMCZAK. That is right.

Representative REUSS. If this were so, and if the function of the Federal Reserve Board, therefore, were very largely concerned with open market policy, reserve requirements, and the rediscount rate, what would you have to say, then, about a recommendation that the membership be reduced from seven to five?

Mr. SZYMCZAK. I still think that that is incorrect.

No. 1, I find that more and more Board members who have been accused of living and working in the ivory tower must travel more and more. They have to go around the country, to labor, to industry, to banking, and so forth; and now more and more they have to go abroad.

More and more we are interested in our balance of payments. We are interested in the exchange rates. And so, therefore, the Board members will have to travel abroad. If you have only five, you will have the problem of a quorum. Therefore, I suggest that you keep the seven, even though frequently I too get tired of listening to them and tired of getting their views, and I would much rather have them accept my views right away and not delay action.

Representative REUSS. Fine. I appreciate your answer. Let me now go into another problem you have raised, the increasing international involvement of the Federal Reserve. I should think that the extent to which the Federal Reserve is from here on out involved in international monetary matters depends very largely on the decision by the Congress, the executive branch, on just where these powers should be lodged.

For example—and to make what I want to say a little clearer—if there should be a decision that the kind of central bankers' arrangement at Basel, Switzerland, in March 1961, be the order of the day, then, indeed, Federal Reserve Board members could be expected to be on the plane to Zurich about once a month.

If, on the other hand, it were determined by the Congress and the executive branch that the basic international monetary decisions by this country should be made not by an independent agency, but by parts of the executive branch such as the Treasury or wherever, then I should think that the involvement of the "Fed" in international monetary matters would be less than would be the case on the other assumption.

Mr. SZYMCZAK. When I first came on the Board, that was true. I mean I felt that we were just interested as a Board in the domestic economic situation, and for a long while that was very evident.

The time came when we started to get interested in the international effect of what was happening abroad on our economy, before the formulation of monetary policy, and even today, although the Treasury has most of the responsibility on gold and other foreign exchange matters because at one time the Federal Reserve had gold, that is still in the act, it has been transferred to the Treasury, but the Federal Reserve must know and must hear the discussions abroad not only from other governments, but also from other agencies of other governments as they meet in Basel or elsewhere from time to time, especially now that the OECD is coming into existence.

In other words, if for no other reason than informative reasons, to get informed as to what is going on abroad, and the effect that that is likely to produce on our economy and our situation here, banking or otherwise.

In other words, they ought to know more about labor and they ought to know more about industry and about the consumer. They ought to know more and more now about the international situation. Therefore, there is only one way of learning it directly and effectively, and that is to go there, because we can read all the books and read all the statistics and still not have the true picture.

Representative REUSS. On the point I will ask a final question.

I do not see in your comments before us this afternoon any particular reference to a recommendation of the CMC that the Federal Reserve Act should be amended so as to include in its goals not merely the provision of a flexible currency and the other things that are in there now, but a set of goals similar to those which are contained in the Employment Act of 1946; namely, the maintenance of maximum production, employment and purchasing power.

Would you think that it is necessary or desirable?

Mr. SZYMCZAK. Yes, I do.

Representative REUSS. To amend the Federal Reserve Act along those lines?

Mr. SZYMCZAK. Yes, indeed.

Representative REUSS. You do?

Mr. SZYMCZAK. Oh, yes.

Representative REUSS. You agree with the recommendations?

Mr. SZYMCZAK. Oh, yes, indeed, definitely. I think they use the three terms—growth, price stability, and what is the third one, productivity?

Representative REUSS. Full employment.

Mr. SZYMCZAK. Full employment, that is right. Not quite full but relatively full.

Representative REUSS. Maximum.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. No questions, thank you, Mr. Chairman.

Chairman PATMAN. I happened to be the coauthor of the full employment bill and was the House author. About the only concession we made in the whole bill was we changed "full employment" to "maximum employment." I have never yet found out exactly what the difference was.

Representative REUSS. Every administration since has carried out your mandate. We have not had full employment.

Chairman PATMAN. Well, we had a mandate for full employment, but, of course, it did not work out like we wanted it. But I think the language is there that would permit it.

Has there been any effort made to keep the Federal Reserve portfolio from going above $27 billion?

Mr. SZYMCZAK. I do not recall any effort.

Chairman PATMAN. Why did you just keep it around $27 billion? Why do you not increase it to 54?

Mr. SZYMCZAK. I do not know. I am the longest on the Board, Mr. Chairman, but I will speak frankly. I do not know. There is no consideration to the profit motive or earnings motive in the open market operation, whether it is $27 billion or $10 billion or $5 billion.

I remember the concern many had that we were increasing the portfolio in the beginning in the early 1930's. There was considerable concern. But the operations of the open market have to do with the supply or nonsupply of reserves. It happened to work out that in that way we now have about $27 billion. No conscious effort is made to decrease it or increase it.

Chairman PATMAN. Of course, there is a way you can handle those reserves. They can be raised as well as lowered.

Mr. SZYMCZAK. Oh, yes.

Chairman PATMAN. I do not believe you have raised——

Mr. SZYMCZAK. You mean the reserve requirements?

Chairman PATMAN. You have not raised them in 8 or 10 years, have you?

Mr. SZYMCZAK. No, we used to. I remember in 1937, just shortly before that we received power to change reserve requirements, we went all the way up and then we had to take it back.

Chairman PATMAN. I think that was to prove that the payment of what they called the "soldier bonus" was bad.

You had to prove that by doubling the reserve requirements of banks and making everything bad so you could say, "We told you so." But that is the first time in history that the reserve requirements of banks were doubled. It was doubled very soon after the payment of that huge sum of money on June 15, 1936.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. I have always thought it was deliberate. I cannot prove it, but I always thought it was deliberate.

Now, on this $27 billion, as it is now, you pay nearly $1 billion into the Treasury on interest, do you not?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. And if I understand it right, and I want you to correct me if I am wrong, all these transactions are done in the Federal Reserve bank in New York?

Mr. SZYMCZAK. That is correct.

Chairman PATMAN. The other 11 banks do not touch that at all, do they?

Mr. SZYMCZAK. That is correct, more or less. They buy some but it is very small in proportion.

Chairman PATMAN. Of course, they do it through the dealers, do they not? They cannot even buy them from——

Mr. SZYMCZAK. I do not even know whether they do it through the dealers. Sometimes they buy them directly from the banks.

Chairman PATMAN. You are on the Board, but my information is that they have got to buy them from the dealers.

Mr. SZYMCZAK. That is New York. I do not know about the others.

Chairman PATMAN. Anywhere?

Mr. SZYMCZAK. I beg your pardon?

Chairman PATMAN. Anywhere, Richmond, San Francisco, Dallas.

Mr. SZYMCZAK. That could be, I do not know.

Chairman PATMAN. Chicago.

Mr. SZYMCZAK. It is a small amount.

Chairman PATMAN. Cleveland.

They have to buy from the dealers. The fact is this Open Market Committee operating with the people you have placed in charge there are under the supervision of the Federal Reserve Bank of New York?

Chairman PATMAN. They keep their portfolio of bonds there and the other banks never touch or see them. They have nothing to do with them?

Mr. SZYMCZAK. That is right.

Chairman PATMAN. Now, the other banks, they make very little money on discounts and things like that, is that correct?

Mr. SZYMCZAK. That is correct.

Chairman PATMAN. About 3 cents out of every $100 comes from the real operations of the Federal Reserve System. That is about all, is it not?

Mr. SZYMCZAK. Well, I do not know the figure, but it is very small.

Chairman PATMAN. It is about that, 3 cents out of every $100. So the money that is made to sustain all these other banks is made there in New York and the other banks have nothing to do with it at all. They get just what you might call a bonus or a subsidy in getting their share of the profits from the interest paid by the Treasury to the Open Market Committee?

Mr. SZYMCZAK. That is true.

Chairman PATMAN. Now, if the Open Market Committee bought more of these Government bonds as they were offered, I would not want you to buy them in a way that would be disturbing to the market, but when they were offered and they needed a purchaser, if the Open Market Committee was the purchaser and bought those bonds, even if they bought up to $50, $75 or $100 million worth, how would that injure the economy, or what harm would there be? You can see what the good would be.

The good would be the money that is paid by the Treasury in interest would flow back into the Treasury, and instead of paying, say $1 billion back into the Treasury now, you would pay about $3 or $4 billion back into the Treasury. We know that is good. Where would there be any harm in that?

Mr. SZYMCZAK. The harm would be in the excess reserve position of the banking system if they keep on buying Government securities.

Chairman PATMAN. There are ways of correcting that. You can raise the reserve requirements of banks.

Mr. SZYMCZAK. In other words, keep on buying and create the excess reserves and then——

Chairman PATMAN. I would do it slowly and gradually. You see, the increased business of the country might take care of it. But I would not permit a disturbance or a runaway market or anything like that.

But when the timing was ripe to buy these bonds, then let the interest flow back into the Treasury rather than let the banks buy them.

What service does a commercial bank render to the Government when it buys Government bonds? Do you know of any service it renders?

Mr. SZYMCZAK. When a bank buys?

Chairman PATMAN. Yes.

Mr. SZYMCZAK. It provides the Government with the funds that the Government requires then and there in order to run the Government.

Chairman PATMAN. I know, but what ——

Mr. SZYMCZAK. In other words, the Government is a borrower and it borrows from whoever will lend it money.

Chairman PATMAN. I read one of your books, and it said that when a customer goes into a bank to borrow money, the reason he signs a note agreeing to pay an interest charge, is because the bank's credit is better than the borrower's credit. He is buying a better credit—the bank's credit—therefore, it is necessary to pay an interest charge for it.

That is not true as to the Government's bonds because the Government does not need the commercial banks to buy its bonds. The Federal Reserve banks can buy every bond that the commercial banks can buy. Then the interest, instead of going into the private bankers' profits, would go into the Government and save the taxpayers that much money.

Mr. SZYMCZAK. In fact, the Government could just create the money on its own—period.

Chairman PATMAN. It is not necessary to do that.

Mr. SZYMCZAK. Well, it has happened in history.

Chairman PATMAN. It has happened back during the War Between the States.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. And I had one estimate one time, of that $346 million issued by Mr. Lincoln, if that had been borrowed at 5 percent interest compounded semiannually, it would be $15 billion now. The Treasury of the United States figured that out. I am not advocating issuing that kind of money.

Mr. SZYMCZAK. I know you are not.

Chairman PATMAN. But I am just stating——

Mr. SZYMCZAK. The close relationship between the banking system and the Federal Reserve and the Treasury.

Chairman PATMAN. That is right. Any bond that the Government needs to sell to commercial banks and create the money to buy these bonds on the books, the Federal Reserve banks could buy. Why should the commercial banks be allowed to buy long-term bonds anyway, Mr. Szymczak? Is that not kind of inconsistent?

Mr. SZYMCZAK. Well, as you know, some time back, I think it was during the war, when Marriner Eccles was chairman of our Board, we do remember the Treasury issuing securities upon our recommendation up to a certain figure—I think it was up to 5 years—which were purchasable by the banks.

Chairman PATMAN. Yes, sir.

Mr. SZYMCZAK. And sometimes the Treasury followed the suggestion of the Board and sometimes it did not. But it is good banking

not to hold too many long-term securities or loans over whatever a commercial bank uses to extend credit with. Therefore, that makes sense.

But the moment you start selling directly to the Treasury, there is a limitation now, as you know.

Chairman PATMAN. $5 billion, yes.

Mr. SZYMCZAK. That is right. I mean from the Treasury to the Federal Reserve.

Chairman PATMAN. Congress could remove that, you know.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. There did not use to be any limit at all.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. You are out of the Board now, and I think you can freely answer the question. I am not saying that you would not anyway.

Mr. SZYMCZAK. Yes.

Chairman PATMAN. When you were a member of the Board, you were always very forthright and answered our questions fully and completely.

Now I have been concerned about the commercial banks buying long-term, tax-exempt bonds. In the Federal Aid to Education fight, a lot of people contend that the local communities cannot vote any more bonds, and if they vote bonds, they have to pay an extortionate rate of interest on them.

It has been brought out that the local private property is heavily mortgaged and bonded anyway, and when school districts vote a bond issue to build a schoolhouse, the owners of real estate and tangible property will have to pay an additional ad valorem tax for the purpose of paying the interest on these bonds and amortizing them to pay them out when they are due.

Mr. SZYMCZAK. That is right.

Chairman PATMAN. Of course, people owe for this property. They already have mortgages on their farms, ranches, businesses, all real estate, some are mortgaged up to 90 percent, the veterans.

Well, now they are paying taxes on that property in that school district to pay the interest on the bonds as though they own that property, when they do not own it, they owe for it. That is a very burdensome tax to pay taxes on what you owe. Now, then, they pay that tax and some bank has bought the bond, just by a flick of the pen, manufacturing the money to do it without cost. When the bank collects that interest from the money that was paid in that hard way, it is tax exempt. It looks to me like it is kind of hard to justify that in a free society where people are supposed to be honest with themselves and with one another.

Mr. SZYMCZAK. As you know, Mr. Chairman, that has come up time and again for discussion, these tax-exempt bonds have come up time and again for discussion as to whether or not there should be any such thing as a tax-exempt bond.

Chairman PATMAN. I am talking about long term—here are commercial banks, No. 1, manufacturing money to buy long-term bonds of any kind.

Mr. SZYMCZAK. That is right.

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Chairman PATMAN. No. 2, a double wrong, buying long-term, tax-exempt bonds with the money. They have bought nearly a third of them, 30 percent of all outstanding tax-exempt bonds, do you know that?

Mr. SZYMCZAK. No, I did not know that.

Chairman PATMAN. Thirty percent. Now, that is something I think that ought to be looked into. It seems to me that the Federal Reserve Board might have an obligation to invite the attention of Congress to things that are getting out of hand like that.

Mr. SZYMCZAK. I did not notice anything about that in the Monetary Commission report.

Chairman PATMAN. No, sir, I did not either.

Has the present Chairman, Mr. Martin, divided up the powers of the different members in a way so that, say, you would have charge of personnel when you were down there?

Mr. SZYMCZAK. No.

Each Chairman, in my experience, operates differently. When I first came on the Board, Eugene Black was Chairman of the Federal Reserve Board, and subsequently Marriner came on first as Governor and later as Chairman of the Board of Governors, and then came Tom McCabe and then came Bill Martin.

Each Chairman, in my experience, operates differently. In other words, under Marriner, each Board member or staff were given certain assignments and they carried on under those assignments, and then came to the Board with recommendations.

Under Tom McCabe, that was followed partially, but not entirely.

Under Bill Martin, we have a Board meeting every day instead of twice a week. And so all subjects are discussed at the Board meeting, and then if they cannot be resolved, they are assigned to individual Board members or staff to come in with a recommendation.

Chairman PATMAN. Did he assign, say, personnel problems to a different one?

Mr. SZYMCZAK. Oh, yes.

At the present time I think Governor Shepardson—first, it was Balderston and then Shepardson have had personnel problems.

Chairman PATMAN. Each one has a certain field?

Mr. SZYMCZAK. In a general way, according to their competence. I was originally assigned by Marriner to the international field and regulation W, T and U, and whatever came up. And so, therefore, after a while I found that I got into the international field and that was a new assignment, and even until recently, until I resigned from the Board, I still had a great many matters that were assigned to me by the Board and by the Chairman in the international field, even though he did not follow the assignment procedure.

Chairman PATMAN. When you left there, what were the assignments of the different ones, as you remember?

Mr. SZYMCZAK. Governor Robertson was more or less in the bank supervisory field because he came from the Comptroller's Office.

Governor Balderston took over on the various matters that had come up in the absence of the Chairman.

Governor Shepardson got into the personnel very quickly and stayed with it, both at the Federal Reserve banks and at the Board.

Governor Mills got into meetings of the various councils, the Federal Advisory Council and others here in Washington, and also was asked for his opinion vis-a-vis Robertson who came from the Government and Mills came from banking, and the two would give freely the same views and sometimes differing views. And so that was about the way it was set up.

Chairman PATMAN. What about Mr. Martin, the Chairman?

Mr. SZYMCZAK. Well, his work was mostly in the monetary field.

Chairman PATMAN. Monetary policy?

Mr. SZYMCZAK. Yes. And, also, he was the responsible man for the Board.

Chairman PATMAN. Thank you very much, Governor Szymczak.

Mr. SZYMCZAK. Thank you, Mr. Chairman and members of the committee.

Chairman PATMAN. We appreciate your testimony.

The committee will stand in recess until 10 o'clock in the morning in the Old Supreme Court Chamber in the Capitol. We will have as our first witness, along with Mr. Wilde, who is returning, Mr. Leon Keyserling. That will be on monetary policy, tomorrow morning at 10.

Tomorrow afternoon, we will have fiscal policy, and we will have as our witnesses Mr. Robert N. Nathan and Prof. James M. Buchanan and Prof. Carl Shoup.

Without objection, we will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 3:35 p.m., the hearing was adjourned, to reconvene at 10 a.m., Tuesday, August 15, 1961.)

REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

TUESDAY, AUGUST 15, 1961

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

The Joint Committee met, pursuant to recess, at 10 a.m., in room P-63, U.S. Capitol Building, the Honorable Wright Patman (chairman) presiding.

Present: Senator Douglas (cochairman); Representatives Patman, presiding; Reuss, and Griffiths.

Also present: William Summers Johnson, executive director, and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN. The committee will please come to order.

We are continuing the hearings on the report of the Commission on Money and Credit, and the subject this morning is monetary policy.

Mr. Frazar B. Wilde is our first witness. He was chairman of the committee. We had the benefit of his testimony yesterday, and we are glad to have him again this morning on the subject of monetary policy.

You have a prepared statement, I believe.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN OF THE COMMISSION ON MONEY AND CREDIT

Mr. WILDE. Yes; I do, sir.

Chairman PATMAN. You may proceed in your own way, sir.

Mr. WILDE. Thank you, Mr. Chairman.

This morning I will comment briefly on the findings and recommendations of the Commission in regard to monetary policy. This is the area of our work about which there is the most extensive literature, accumulated experience, and with which the largest number of us had some familiarity. It is also one to which the Congress has paid a great deal of attention in studies and investigations, and to which your committee has made such important contributions.

The Commission started with the fundamental assumption that control over conditions governing the quantity of money is desirable and inevitable in a modern industrial society such as ours. As the Nation has developed more positive economic goals, it has become interested in how and to what extent monetary control can be used flexibly to influence the behavior of expenditures, output, employment, and prices. The Commission examined monetary policy in this content.

In the United States monetary policy is essentially Federal Reserve policy, which operates primarily through the system's exercise of conscious and continuous control over the reserve position of commercial banks. Because this type of action is general, pervasive, and indirect, and because with one exception no attempt is made by the monetary authority to allocate credit among specific users, this approach to monetary policy is frequently referred to as general monetary control.

Our study centered around a series of key questions which had been raised about general monetary policy over the years, and the report deals with each of them. How does general monetary policy work? Is it useful and effective as a tool for economic stabilization? How can it contribute to economic growth? How can the instruments of general monetary control be improved to increase their effectiveness? Should selective controls be employed to supplement the instruments of general monetary control? Should the span of monetary control be enlarged by the imposition of direct controls over nonbank institutions?

We have accumulated and studied the available evidence. We have tapped the expert knowledge of the Federal Reserve System and the Treasury. We have sought the advice of academic experts. We have utilized to the full the wide-ranging experience of the members of the Commission. The Commission's judgments grew out of this study and discussion process.

I shall not comment in detail on how general monetary control operates. Your committee is familiar with the process. But I do want to make a few points. General monetary control influences expenditures through its effect both on decisions made by lenders and by the decisions of spending units, that is, business, individuals, and governments. It affects the willingness and ability of nearly all institutional lenders, not just commercial banks, to meet the credit demands of the economy. By its influence on credit terms and interest rates it affects directly some types of spenders more than others. Its indirect effects on spenders are widespread. Finally, while the processes and channels through which monetary measures operate are the same for a policy of ease as for a policy of restriction, an expansionary policy may be less effective at times than a restrictive policy.

There is some general agreement about the nature of the processes through which monetary policy affects economic activity. Some experts contend, however, that monetary policy does not have large enough effects to be useful or has effects which are too powerful and others contend that an active monetary policy works too slowly to be useful. Still others contend that monetary measures for stabilization are discriminatory in their application, with their restrictive effects falling particularly severely on investment in housing and in small business. And it is claimed that monetary restraint affects adversely the distribution of income among individuals. We examined all these contentions.

The effectiveness of countercyclical monetary policy must be considered in relation to the objective it seeks to achieve. For example, the purpose of restraint during prosperity is to exert a moderating effect on total spending so as to prevent unsustainable boom conditions; its purpose is not to extinguish a large proportion of demand.

The Commission concluded that changes in the degree of monetary restraint or ease do not have a controlling effect on any specific type of expenditure, but the pervasive and cumulative combination of a number of small effects make flexible monetary policy a useful instrument of stablization policy.

As to the speed of the effect of monetary policy, some experts have argued that it works so slowly that its effects become perverse, because the effects of a restrictive policy are not felt until after the start of the ensuing downswing and the effects of monetary expansion until after the start of the next boom. The evidence available on the timing of monetary policy's impact is inconclusive. But, it is clear that general monetary policy is not something that has a substantial immediate impact; rather it has a gradual cumulative impact.

Our conclusion was that the speed of that impact was such as to make monetary policy a useful and effective instrument of stabilization policy. Although monetary ease or expansion can be and sometimes has been carried on for too long, this reflects the inadequacy of techniques employed and the citeria used in timing changes in policy rather than inherent defects in monetary management. Also, certain actions can be taken which will speed up the effects of monetary policy. For example, monetary restraint on the upswing would be more rapid and effective if bank liquidity at the start of the upswing is not excessive.

As for differential effects, monetary policy has had a greater direct impact on the availability of mortgage credit for residential building than on any other major type of credit. To a considerable degree this stemmed from the interest rate ceilings on insured or guaranteed mortgages. But even without the ceilings the mortgage market would probably be more sensitive to credit restraint than other spending areas. Because residential construction tends to move inversely with the business cycle, it contributes to stabilizing the economy as a whole. However, the countercyclical behavior of residential construction only partially offsets the cyclical variations in total construction. The Commission believes, therefore, that the cyclical impact of monetary policy on residential construction has not been undesirable.

Bank credit rationing to business did occur in periods of credit restraint and was not uniform in its impact. But the criterion for rationing did not appear to be size of firm. The limited evidence available was not convincing that lenders treated large borrowers any differently than small borrowers at different times in the cycle. The two criteria which prevailed for business loans appeared to be creditworthiness and the value to the bank of obtaining or retaining the borrower as a depositor.

The income distribution effect of monetary policy is difficult to measure. On the assumption that some restraint is necessary and that employment will be the same if any of the following three measures is used, monetary restrain may be considered an alternative to outright inflation or as an alternative to the control of demand by fiscal policy. It is not at all clear that income distribution will be worsened by the use of monetary policy as compared to the other two measures. Hence, the Commission saw no reason to object to the use of monetary policy because of its direct income distribution effects.

In summary, the Commission concluded that monetary policy is a valuable and effective instrument of stabilization policy. It does not advocate placing sole reliance on monetary policy for stabilization purposes. Because of its reversibility and the possibility of changing policy by small steps, monetary policy can be used in many circumstances when discretionary fiscal policy changes should not be used because the need for so powerful an instrument has not yet become clear. Monetary policy clearly is valuable and should be one of the instruments of stabilization. It cannot, however, be expected to attain stabilization alone in the face of conflicting fiscal, debt management, and other credit policies.

In addition to thinking of general monetary policy as a stabilization measure, we considered it also in terms of its relationship to growth. In the long run the Nation has to have an expanding monetary supply to contribute to economic growth. We were not convinced, however, that the best way to do this was by some formula in the form of a fixed percentage of increase in the money supply per year. We urged that the average rate of growth of the money supply should be consistent with the continued maintenance of high employment and stable prices and adequate economic growth, but we recognized that it may be appropriate for the money supply to grow more or less rapidly than the output of the economy at high employment.

In another dimension, we stated that monetary policy should be governed primarily by domestic economic needs. The use of monetary, credit, and fiscal measures to achieve adequate growth, high employment, and reasonably stable prices, however, should contribute to an improvement in our payments balance. We suggest, however, the desirability of removing the present 25-percent gold reserve requirement against Federal Reserve note and deposit liabilities so that it would be generally recognized both here and abroad that all of the U.S. gold was available to meet our international obligations.

The report then goes on to make certain suggestions and recommendations relating to each of the three major instruments of general monetary policy, open-market operations, rediscount rate and discount policy, and the power to alter the reserve requirements of member banks within specified limits.

Open-market operations should constitute the primary instrument of general monetary policy, primarily because of their flexibility with respect to timing and magnitude. A major issue in regard to open-market operations, however, related to the policy followed by the Federal Reserve from 1953 to early 1961 to confine such operations to short-term Government securities, generally to Treasury bills. On this the Commission recommended that instead of relying on a "bills only" policy the Federal Reserve should be willing, when domestic or international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varied maturities. This recommendation does not mean a return to a pegged structure of prices and yields for Government securities. The Commission is unequivocally opposed to any return to the system of pegged rates which existed before the accord of 1951. It also stated that the normal use of open-market operations in bills to carry out technical and seasonal changes in bank reserves is appropriate.

As to discount policy, the Commission concluded that the discount facility should be retained as a source of temporary credit. The Federal Reserve should provide liquidity directly to the commercial banks in times of general or regional economic distress, and the banking system should be assured that this will be done. The Commission urged further that continued efforts be made to assure uniform standards of discounting practice among the 12 Federal Reserve banks. Uniform standards, of course, mean that like circumstances result in like treatment, at the same time permitting differences in practice where regional differences and economic conditions or needs require.

The Commission examined the numerous proposals which have been put forward to eliminate the sometimes adverse effect caused by a changing relationship between the rediscount rate and open-market rates. The Commission rejected these various types of formula proposal and favored the fully discretionary system. It urged, however, that the rediscount rate be administered to avoid effects counter to those sought by open-market operations.

The Commission also recommends that a uniform rediscount rate be established for all Federal Reserve banks. This would eliminate even temporary regional differences in discount rates among the 12 Reserve banks and would result in a national discount rate policy to correspond with a national open-market policy.

As to reserve requirements, the Commission concluded, after examining many alternative proposals for setting reserve requirements, that the present general form of fractional reserve requirements against net demand deposits is adequate for the purposes of general monetary policy and recommended that it be continued. The Commission did recommend, however, that the demand deposit reserve requirements for all member banks be made identical and that the classification of banks into country banks and Reserve city banks be eliminated. It further recommended that the existing statutory reserve requirements against savings and time deposits be repealed, and that, pending repeal of such requirements, those banks and competing thrift institutions subject to them be permitted to hold reserves in the form of either cash or Treasury securities with maturities up to 5 years.

The Commission also recommended that Congress continue to grant to the Federal Reserve Board a range within which reserve requirements can be set for demand deposits, so that the Board can adjust the specific level to meet the needs of growth or to meet emergency needs. The Commission stated, however, that the power to change reserve requirements up or down should be used only sparingly; it favors major reliance on the use of open-market operations rather than changes of reserve requirements for countercyclical adjustments.

The Commission then considered the advisability of strengthening the effectiveness of monetary policy by the use of selective monetary measures. The only selective control available to the Federal Reserve authorities today is the power to alter margin requirements on credit granted by any lender—banks and others—for the purpose of purchasing or carrying listed securities. This selective control is useful and should be continued. It then went on to consider selective controls over other specific uses of credit to control volatile sectors of spending, such as spending on consumer durable goods, housing, inventory accumulation, and industrial plant and equipment. As a gen-

eral guide the Commission concluded that whether the Federal Reserve should be granted additional powers to alter the pattern of credit and resource allocation through exercise of new selective controls hinges largely on whether particular types of changes in the composition of spending among broad classes of output not readily affected by general controls can be identified at the time as being so destabilizing as to threaten the achievement of major economic objectives, and on whether there are efficient means to affect those types of spending and output in the desired directions.

The Commission examined the long-run impact of consumer credit on the economy as well as the charge that installment credit has been a source of cyclical instability. It also examined the effectiveness of the types of consumer credit controls which have been used in the past. The Commission was almost evenly divided as to the desirability of granting standby authority to the Federal Reserve Board for consumer credit controls, and in consequence makes no general recommendation in regard to them. It does, however, urge an investigation of better forms of such controls which could be administered more effectively if they should be needed.

The Commission did recommend that the terms of residential housing loans insured or guaranteed under VA and FHA programs should be varied in support of the Government's countercyclical policies. These changes, however, would be administered by the VA and FHA.

As to selective controls over business spending for inventory accumulations and for plant and equipment purchases, the Commission recognized the difficulties of either selective credit controls or other types of selective controls. No seemingly effective selective control device has yet been devised for regulating these volatile business expenditures. It may well be that more effective controls of such expenditures than general credit measures will be necessary to achieve our major economic objectives, and the Commission suggests that possible methods of influencing these expenditures on a selective basis be investigated by the Government.

Finally, as to the span of monetary controls, the Federal Reserve has direct control over the reserve position of the approximately 6,000 commercial banks which are members of the System, although its indirect influence is felt through the entire credit market. The fact that nonmember banks are not subject to the same reserve requirements as members and the fact that the public holds a large volume of its liquid assets at nonbank institutions, such as savings and loan associations and mutual savings banks, have been cited as potential and actual sources of escape from the impact of monetary control. This has led to suggestions that the direct reach of Federal Reserve control should be extended to cover such institutions.

The present basis for setting nonmember bank reserve requirements permits some escape from the influence of monetary policy in the commercial banking system. Also, because many nonmember banks make an exchange charge in settling checks drawn upon them, this constitutes an imperfection in the payments mechanism. While neither of these problems is too serious, especially on a national basis, they are of importance in certain regions. The Commission recommended that all insured commercial banks should be required to become members of the Federal Reserve System.

The more rapid growth of nonbank financial intermediaries than commercial banks along with the consequent rapid increase in the public's holdings of all forms of liquid assets has focused attention on the question of their significance as a potential offset to monetary policy. Because of their closeness to money, changes in the volume of these near-money assets may have an important effect on the demand for money balances and hence on the velocity of money.

The Commission examined both the cyclical and secular aspects of these developments. The velocity effects attributable to movements of funds out of currency and demand deposits into claims on nonbank financial intermediaries do not appear to be great. The argument that the cyclical behavior of velocity has been caused by systematic shifts of individual and business funds out of money assets into near money thrift deposits during periods of monetary restraint is not supported by the facts. The velocity increases that do occur during booms have other causes, principally the shift of corporate balances into earning assets and the reduction of household balanced to purchase goods and services. In addition, the evidence, although fragmentary, suggests that portfolio adjustments by private nonbank financial institutions do not contribute significantly to the cyclical variations in velocity.

The evidence also suggests that although money substitutes play some role in secular velocity movements, it is not an important one. The evidence of either a cyclical or secular character does not support a case for an extension of the direct monetary controls over nonbank financial intermediaries. Their contribution to cyclical changes in velocity appears to be too small to warrant such an extension. Their effect on velocity over the long run can easily be taken into account in regulating the long-run money supply. Consequently, the Commission recommends that there be no extension of direct Federal Reserve controls, such as reserve requirements, over nonbank financial institutions.

However, one kind of control over commercial banks that is not imposed on nonbank financial intermediaries deserves attention. This relates to interest payments on time and savings deposits, which are subject to ceilings imposed by the Federal Reserve. The ceilings restrict the freedom of commercial banks to compete for savings deposits with nonbank intermediaries which are not subject to similar control over the rates they may offer. The Commission recommends that the present statutes authorizing regulation of interest rates on savings and time deposits for commercial banks be converted into a standby authority rather than continuous regulation. The regulation should also permit differentiation among types of deposits, including between foreign and domestic deposits. The same type of regulation should also cover similar liabilities of other thrift institutions. Finally, the regulations should be imposed only when in the opinion of the appropriate authorities further interest rate competition for deposits in deemed not in the public interest.

Some of the recommendations necessarily carry implications as to the organization of the Federal Reserve System but these matters were discussed yesterday by Mr. Eccles.

In conclusion, I want to repeat a most important finding of the Commission. Flexible monetary policy is a useful, valuable, and

effective instrument of national economic policy, and, when used wisely, it contributes to the attainment of economic stabilization and growth. It is, however, but one instrument, and by itself it cannot assure the attainment of our goals. It must be used in combination with fiscal, debt management, and other credit policies, as well as with noncredit economic measures, to achieve our national objectives.

Chairman PATMAN. Thank you, Mr. Wilde. Knowing that you want to get away to go back to your business in Connecticut—and I am in sympathy with your efforts; you told me about them and you have given a lot of time to this committee. I will ask that the reporter write in the transcript questions which you may answer when you revise your transcript.

If you will do that, I would appreciate it.

(Chairman Patman's questions and Mr. Wilde's answers thereto follows:)

Question. 1. Mr. Wilde, in your statement, you say that you have been interested "in what extent monetary controls can be used to influence the behavior of expenditures, output, employment, and prices."

(*a*) Was it the Commission's belief or findings, after examining this matter, that the Federal Reserve is now and has been for several years using flexible monetary controls to influence the "behavior of expenditures, output, employment, and prices"? Or is this a new idea that you are proposing?

(*b*) Are there any other purposes for the Federal Reserve's monetary decisions other than to influence the things you have mentioned?

Answer. 1. (*a*) There was no doubt in the minds of the Commissioners that the Federal Reserve has been using flexible monetary controls to influence "the behavior of expenditure output, employment, and prices." This is certainly not a new idea that the Commission is proposing. However, you will recall that many individuals have argued that monetary policy should not be used because it is not effecive or that any results it does achieve are realized at too high a cost. The Commission therefore found it desirable to examine whether monetary policy could be effective as an economic policy instrument, and whether the costs of monetary policy in achieving its objective were excessive relative to the cost that other policies might incur if they were to be used to achieve the same group of objectives.

(*b*) The Federal Reserve does concern itself with economic variables other than the behavior of expenditures, output, employment, and prices, although these are central to its interests. It is interested in the U.S. balance of payments and changes in U.S. gold stock. It is interested in a minimum number of economic controls and in preserving a large role for free economic decision. It is interested in the safety of bank deposits and in seeing that banking services are provided at low cost.

Question 2. Mr. Wilde, in your statement, you say that residential construction tends to move inversely with the business cycle and thus contributes to stabilizing output as a whole.

Do you know of any reason why residential construction increases when general business goes down, except for the fact that when general business goes down, interest rates are decreased?

Answer 2. It is true that the residential construction cycle has moved inversely with the business cycle. This observed result can be traced to several different factors, in addition to the decline in interest rates which you mention. One is that as the business demand for funds declines during the recession phase of the business cycle, banks and other lenders have more funds to make available to home buyers. This is particularly relevant with regard to loans made under FHA and GI mortgages. As you know, these mortgages have maximum interest ceilings. When lenders find in periods of boom that they can obtain more interest or the same interest on a relatively safer security, than on FHA or GI mortgages, they shift funds away from mortgage credit to business credit. But the demand of individuals for FHA and GI mortgages remains, and this demand is partly met during the recessionary phase of the business cycle as more funds become available for these mortgages. The interest rates

on the FHA and the GI show relatively little cyclical flexibility, while the variation in supply of funds for these mortgages is really quite large.

Another factor which is surely important is the supply of resources available for home construction. Now it is true that some resources used in home construction cannot be shifted to other construction uses. But it is also true that a large part of the labor, and even some of the materials, can be shifted. In periods when business demand is weak, therefore, it becomes possible for some supply factors which were formerly occupied in meeting the demands of business to meet the demands of homebuilding.

Question 3. You acknowledge that bank rationing of credit to business firms has occurred in periods of credit restraint. But you say that the criterion for rationing did not appear to be based on size of firm; on the contrary, you state that the two criteria which prevailed appeared to be credit worthiness and the value to the bank of obtaining or retaining the borrower as a depositor.

Would you argue that as a general rule the banks would not get the same result if they used the size of firm as a criterion, for favoring some firms over others, than they got by using the two criteria which you mentioned?

Answer 3. You will note, Mr. Chairman, the Commission considered the problem of the adequacy of credit for small business on pages 58 and 196–197 of the report. I believe it would be the opinion of most members of the Commission that the results of using size of firm as the criterion for bank lending rather than using creditworthiness or the value to the bank of obtaining or retaining the borrower as a depositor would have vastly different results. There are many differences between the creditworthiness of some large borrowers and other large borrowers, between that of some small borrowers and other small borrowers. If banks, as a general rule, were simply to rely on the size of the firm as a criterion, they might find that they were making risky loans to large borrowers, and at the same time were denying funds to good customers who are creditworthy and who happen to be small borrowers.

The credit problems of small business are largely a problem of their inadequate equity, rather than of credit discrimination. The Commission stated the small business investment corporations, a credit program of the Small Business Administration, were a promising venture, and that if they prove inadequate, a loan insurance program might be devised to better meet this need.

Question 4. Mr. Wilde, I want to call your attention to some statistics which were collected by the Federal Reserve Board, at my request, and which show the distribution of bank credit to business by size of firm in October 1955, and again in October 1957.

You may recall that October 1955, was a period of easy credit, relatively speaking. From that time on through the next 2 years the Federal Reserve made credit tighter and tighter until it set just about an alltime record for tightness in October 1957.

But your biggest corporation—those with assets of more than $100 million—had 66 percent more bank credit in October 1957, than they had had in October 1955.

At the other extreme, the small companies with less than $50,000 of assets had 3 percent less bank credit than they had had 2 years earlier. Furthermore, for the intermediate size classes, the bigger the firm, the greater the increase in credit.

Without objection I will insert in the record several tables from the Federal Reserve study. This study appeared in a report made to the Committees on Banking and Currency of the Senate and the House and to the Select Committees on Small Business of the Senate and the House.

(The tables referred to are as follows:)

TABLE 1.—*Business loans of member banks, 1955 and 1957, by size of borrower*

Size of borrower (total assets, in thousands)	Amount of loans					Number of loans					Average size of loan		
	Millions of dollars		Percentage change, 1955–57	Percentage distribution		Thousands		Percentage change, 1955–57	Percentage distribution		Thousands of dollars		Percentage change, 1955–57
	1955	1957		1955	1957	1955	1957		1955	1957	1955	1957	
All sizes	30,805	40,618	31.9	100.0	100.0	1,185.2	1,280.6	8.0	100.0	100.0	26.0	31.7	22.0
Less than $50	1,501	1,456	−3.0	4.9	3.6	503.1	504.7	.3	42.5	39.4	3.0	2.9	−3.3
$50 to $250	4,505	5,256	16.7	14.6	12.9	414.9	494.3	19.1	35.0	38.6	10.9	10.6	−2.1
$250 to $1,000	5,051	6,302	24.8	16.4	15.5	125.8	157.6	25.3	10.6	12.3	40.2	40.0	−.4
$1,000 to $5,000	5,586	6,775	21.3	18.1	16.7	37.9	48.2	27.2	3.2	3.8	147.3	140.5	−4.6
$5,000 to $25,000	4,742	5,912	24.7	15.4	14.6	11.0	13.3	21.1	.9	1.0	432.8	445.7	3.0
$25,000 to $100,000	3,240	4,893	51.1	10.5	12.0	4.4	5.4	22.7	.4	.4	732.6	901.6	23.1
$100,000 or more	5,297	8,815	66.4	17.2	21.7	6.0	6.5	7.3	.5	.5	878.8	1,363.5	55.1
Not ascertained	883	1,207	36.7	2.9	3.0	82.0	50.7	−38.2	6.9	4.0	10.8	23.8	121.3

NOTE.—Details may not add to totals because of rounding.

TABLE 2.—*Change in amount of business loans of member banks, 1955–57, by business and size of borrower*

[Increase, or decrease (−). In percent unless otherwise noted]

Business of borrower	Amount outstanding Oct. 16, 1957 (in millions of dollars)	Size of borrower (total assets, in thousands of dollars)							
		All borrowers [1]	Less than $50	$50 to $250	$250 to $1,000	$1,000 to $5,000	$5,000 to $25,000	$25,000 to $100,000	$100,000 or more
All businesses	40,618	31.9	−3.0	16.7	24.8	21.3	24.7	51.1	66.4
Manufacturing and mining:									
Food, liquor, and tobacco	2,392	28.0	−33.5	7.1	23.7	5.4	−4.6	8.5	104.5
Textiles, apparel, and leather	1,685	−3.0	−38.7	−20.7	−7.8	−4.0	−9.5	3.6	47.7
Metals and metal products	5,526	70.5	−18.2	20.1	20.2	46.7	35.1	106.1	151.2
Petroleum, coal, chemicals, and rubber	3,750	44.1	−16.2	2.2	40.3	18.3	7.2	20.4	138.1
All other	2,793	47.2	−7.2	8.4	20.1	46.1	76.1	82.7	119.2
Trade:									
Retail trade	4,588	33.2	3.4	28.3	51.4	48.7	32.3	36.6	33.7
Wholesale trade	2,982	24.7	−10.6	21.8	23.7	17.9	31.0	105.2	134.7
Commodity dealers	816	10.7	−18.8	13.4	44.2	−22.1	−2.4	61.2	20.2
Other:									
Sales finance companies	3,096	9.3	−32.5	−24.0	20.2	−6.6	7.5	36.3	5.9
Transportation, communication, and other public utilities	4,168	47.0	31.2	13.0	10.5	44.6	56.1	84.0	40.0
Construction	1,981	17.1	−7.7	9.4	9.3	23.6	−.5	101.2	310.0
Real estate	2,976	22.5	−24.9	9.9	23.3	17.1	27.6	109.3	19.9
Service firms	2,263	28.3	4.6	29.5	36.2	42.1	79.8	29.7	9.3
All other nonfinancial	1,606	20.4	6.0	18.0	26.9	−1.3	25.1	30.4	96.1

[1] Based on data that include a small amount of loans for borrowers whose size was not ascertained.

NOTE.—Details may not add to totals because of rounding.

TABLE 3.—*Business loans of member banks, 1955–57, by business and relative size of borrower* [1]

Business of borrower	Loans outstanding Oct. 5, 1955				Increase, or decrease (−), 1955–57						
	Millions of dollars	Percentage of industry total, by size of borrower [2]			Millions of dollars	Percentage of industry total, by size of borrower [2]			Percentage change, by size of borrower		
		Small	Medium	Large		Small	Medium	Large	Small	Medium	Large
All businesses	30,805	20.5	44.9	31.7	9,813	6.9	39.5	50.4	10.6	28.0	50.7
Manufacturing and mining:											
Food, liquor, and tobacco	1,869	21.4	55.4	22.4	523	10.0	6.2	83.7	13.0	3.1	104.5
Textiles, apparel, and leather	1,736	33.0	47.2	18.2	−53	[3] −154.4	[3] −95.3	[3] 157.1	−14.3	−6.2	26.3
Metals and metal products	3,241	38.7	36.1	24.0	2,285	16.6	32.0	51.4	30.2	62.5	151.2
Petroleum, coal, chemicals, and rubber	2,603	28.7	44.7	21.7	1,147	13.0	14.5	68.0	20.0	14.3	138.1
All other	1,896	18.6	61.8	18.4	895	2.1	58.9	38.0	5.4	45.0	97.5
Trade:											
Retail trade	3,445	13.8	51.0	33.1	1,144	1.4	56.9	38.9	3.4	37.1	39.0
Wholesale trade	2,392	23.9	56.5	17.8	590	16.0	48.4	37.2	16.5	21.1	51.5
Commodity dealers	736	8.9	36.5	52.3	79	7.4	12.7	78.7	8.9	3.7	16.2
Other:											
Sales finance companies	2,832	25.1	32.1	42.5	263	−2.7	74.9	27.1	−1.0	21.8	5.9
Transportation, communication, and public utilities	2,835	1.7	49.0	46.6	1,334	1.1	53.6	39.7	31.2	51.5	40.0
Construction	1,692	7.8	51.1	38.0	289	−3.5	27.9	62.8	−7.7	9.3	28.2
Real estate	2,430	24.4	22.7	44.7	546	4.1	23.5	52.6	3.7	23.3	26.4
Service firms	1,763	17.4	50.1	27.0	499	2.8	56.7	41.4	4.6	32.0	43.3
All other nonfinancial business	1,333	7.1	37.5	48.8	272	2.1	41.7	46.5	6.0	22.7	19.4

[1] For classification of borrower by relative size, see appendix A.
[2] Figures do not add to 100 percent because some loans were made to borrowers whose size was not ascertained.
[3] Net change for industry was a decrease; sign indicates direction of change for size group.

TABLE 4.—*Broad summary of major outlays and sources of funds of manufacturing corporations, by size of business, 3d quarter 1955–3d quarter 1957*

Outlay or source [1]	All corporations		Size (total assets)					
			Under 5		5–100		100 and over	
	Millions of dollars	Percentage change	Millions of dollars	Percentage change	Millions of dollars	Percentage change	Millions of dollars	Percentage change
MAJOR OUTLAYS								
Property, plant, and equipment [2]	28,867	22.8	1,896	10.6	3,470	12.1	23,500	29.2
Inventories	11,914	27.0	1,648	18.9	2,283	17.5	7,984	35.5
Net receivables [3]	3,501	30.5	582	19.6	1,012	22.5	1,909	47.7
Total	44,282	24.3	4,126	14.0	6,765	14.7	33,393	31.3
MAJOR SOURCES OF FUNDS								
Retained earnings	17,079		3,198		4,397		9,484	
Depreciation and depletion	17,519		2,812		3,516		11,192	
Cash and Government securities	−3,490	−11.9	152	3.5	−843	−11.6	−2,802	−16.0
Borrowings:								
Bank loans:								
Short-term (1 year and under)	3,179	71.6	482	28.7	840	46.2	1,857	196.5
Long-term (over 1 year)	1,543	48.0	365	65.5	452	39.6	727	47.8
Total	4,722	61.7	847	37.9	1,292	43.7	2,584	104.8
Nonbank long-term	4,806	27.0	678	33.7	661	18.3	3,466	28.5

[1] Since only selected items are included, the aggregates of outlays and sources of funds are not in balance. The principle omission is net worth changes (other than retained earnings).
[2] Before deduction of reserve for depreciation and depletion.
[3] Accounts receivable minus accounts payable.

Source: Federal Trade Commission-Securities and Exchange Commission: Quarterly Financial Reports for Manufacturing Corporations.

TABLE 5.—*Maturities of business loans outstanding at member banks Oct. 16, 1957, by size of borrower*

Size of borrower (total assets, in thousands)	Amount (in millions of dollars)				Number (in thousands)				Percentage increase, or decrease (−), 1955–57							
									Amount				Number			
	All maturities	1 year or less	1 to 5 years	Over 5 years	All maturities	1 year or less	1 to 5 years	Over 5 years	All maturities	1 year or less	1 to 5 years	Over 5 years	All maturities	1 year or less	1 to 5 years	Over 5 years
All borrowers	40,618	25,197	7,717	7,704	1,281	801	352	127	31.9	23.8	58.0	38.2	8.0	−2.3	31.3	31.2
Less than $50	1,456	783	412	261	505	295	172	37	−3.0	−15.0	21.0	8.7	.3	−12.4	30.5	8.7
$50 to $250	5,256	3,311	946	999	494	326	112	57	16.7	4.9	47.1	41.7	19.1	6.9	61.1	38.5
$250 to $1,000	6,302	4,506	1,004	792	158	108	32	17	24.8	17.4	48.6	47.7	25.3	13.8	59.7	63.1
$1,000 to $5,000	6,775	4,755	1,292	728	48	33	11	4	21.3	11.3	61.3	42.1	27.2	14.9	72.3	49.1
$5,000 to $25,000	5,912	3,600	1,277	1,036	13	9	3	1	24.7	17.5	52.6	23.0	21.2	10.4	77.5	8.9
$25,000 to $100,000	4,893	2,562	846	1,485	5	3	1	1	51.1	52.8	76.3	37.2	22.7	11.1	73.0	29.7
$100,000 or more	8,815	5,264	1,638	1,913	6	4	1	1	66.4	79.1	79.4	32.5	7.3	21.0	9.4	−18.5
Not ascertained	1,207	416	302	489	51	23	20	8	36.7	−13.4	57.0	132.6	−38.2	−42.9	−47.1	74.8

NOTE.—Details may not add to totals because of rounding.

TABLE 6.—*Term loans as a percentage of business loans at member banks, 1955 and 1957, by size of borrower and size of bank*

Size of borrower (total assets, in thousands)	All banks		Size of bank (total deposits, in millions of dollars)							
			Under $10		$10 to $100		$100 to $1,000		$1,000 or more	
	1955	1957	1955	1957	1955	1957	1955	1957	1955	1957
All sizes [1]	33.9	38.0	27.1	34.7	27.2	32.1	28.5	31.1	42.3	45.6
Less than $50	38.7	46.2	33.9	43.5	38.3	42.6	41.2	48.5	48.0	60.1
$50 to $250	29.9	37.0	28.1	35.2	31.6	37.3	30.9	35.8	25.5	41.2
$250 to $1,000	24.0	28.5	15.9	23.2	24.7	30.7	24.7	29.3	23.0	24.3
$1,000 to $5,000	23.5	29.8	7.0	17.1	19.7	23.4	24.9	28.8	23.4	35.0
$5,000 to $25,000	35.4	39.1	11.0	14.1	18.5	19 7	29.6	32.9	41.0	45.0
$25,000 to $100,000	48.2	47.7	------	15.5	15.9	17.2	30.7	31.9	57.2	55.0
$100,000 and over	44.5	40.3	10.6	6.8	14.6	13.7	31.0	25.4	51.0	45.3

[1] Includes a small amount of loans to borrowers whose size was not ascertained.

TABLE 7.—*Relation of secured loans to total business loans of member banks, 1955 and 1957, within size-of-borrower groups*

Size of borrower (total assets, in thousands)	Amount						Number					
	Total loans (in millions of dollars)		Secured loans				Total loans (in thousands)		Secured loans			
			Millions of dollars		Percentage of total for size group				Thousands		Percentage of total for size group	
	1955	1957	1955	1957	1955	1957	1955	1957	1955	1957	1955	1957
All sizes [1]	30,805	40,618	15,700	20,426	51.0	50.3	1,185	1,281	799	856	67.4	66.8
Less than $50	1,501	1,456	1,191	1,141	79.3	78.4	503	505	347	344	69.0	68.2
$50 to $250	4,505	5,256	3,374	4,023	74.9	76.5	415	494	270	325	65.1	65.7
$250 to $1,000	5,051	6,302	3,452	4,543	68.3	72.1	126	158	80	104	63.3	65.9
$1,000 to $5,000	5,586	6,775	3,296	4,056	59.0	59.9	38	48	22	29	58.6	60.7
$5,000 to $25,000	4,742	5,912	1,996	2,661	42.1	45.0	11	13	4	6	39.3	48.5
$25,000 to $100,000	3,240	4,893	828	1,381	25.6	28.2	4	5	1	2	29.0	31.7
$100,000 or more	5,297	8,815	784	1,546	14.8	17.5	6	6	2	2	37.8	34.7

[1] Includes a small amount of loans to borrowers whose size was not ascertained.

TABLE 8.—*Regional change in business loans of member banks, 1955–57, by relative size of borrower* [1]

[Percentage increase, or decrease (−), in amounts outstanding]

Federal Reserve district	All borrowers [2]	Relative size of borrower		
		Small	Medium	Large
All districts	31.9	10.6	28.0	50.7
Boston	20.1	.1	23.8	36.8
New York	35.8	.6	28.5	55.0
Philadelphia	17.7	9.8	16.8	18.4
Cleveland	43.4	22.4	40.8	65.1
Richmond	20.8	6.7	24.1	32.1
Atlanta	26.5	18.2	26.1	51.1
Chicago	35.0	11.3	22.7	59.9
St. Louis	16.1	−15.6	2.4	33.3
Minneapolis	20.5	2.1	35.3	11.6
Kansas City	17.7	17.2	16.2	29.5
Dallas	19.4	−7.6	17.0	21.1
San Francisco	50.6	46.1	52.1	61.0

[1] For classification of borrowers by relative size, see appendix A.
[2] Includes a small amount of loans for borrowers whose size was not ascertained.

TABLE 9.—*Interest rates on member bank loans to business, 1955 and 1957, by size of borrower and maturity of loan*

[Average rates on loans made between July 1 and survey date. Percent per annum.]

Size of borrower (total assets, in thousands)	1955				1957				Net increase, 1955–57			
	All loans	Short-term (1 year or less)	Inter-mediate term (1 to 5 years)	Long-term (over 5 years)	All loans	Short-term (1 year or less)	Inter-mediate term (1 to 5 years)	Long-term (over 5 years)	All loans	Short-term (1 year or less)	Inter-mediate term (1 to 5 years)	Long-term (over 5 years)
All sizes [1]	4.2	4.2	4.9	4.1	4.9	5.0	5.7	4.7	0.7	0.8	0.7	0.6
Less than $50	5.8	5.5	7.9	5.2	6.5	6.1	8.7	5.8	.7	.6	.8	.6
$50 to $250	5.1	5.0	6.2	5.0	5.7	5.6	7.1	5.6	.6	.6	.8	.6
$250 to $1,000	4.6	4.6	5.2	4.8	5.4	5.4	6.0	5.4	.8	.8	.8	.6
$1,000 to $5,000	4.1	4.1	4.6	4.3	5.1	5.1	5.7	5.1	1.0	1.0	1.1	.8
$5,000 to $25,000	3.7	3.7	3.9	4.1	4.8	4.8	4.9	4.8	1.1	1.1	1.1	.7
$25,000 to $100,000	3.4	3.4	3.9	3.6	4.5	4.6	4.6	4.3	1.1	1.2	.7	.8
$100,000 and over	3.3	3.2	3.2	3.6	4.4	4.4	4.4	3.9	1.2	1.2	1.2	.3

[1] Includes a small amount of loans for borrowers whose size was not ascertained.

Answer 4. The tables which you have presented on business financing between 1955 and 1957 are very interesting. It would be interesting in addition, however, if the tables had been carried back to 1953, so that we could see the pattern of bank financing in the business downswing as well as in the upswing.

The real point at issue is whether the relative increase in bank loans to larger business firms (shown in the data) were due to changes in the supply of funds or changes in the demand for funds. One of the studies we had seemed to suggest that small businesses were continually loaned up with the banks; that banks had extended as much credit to small businesses as they deemed justified by the creditworthiness of these firms and that this held true over the course of the business cycle. This was used to explain the apparent lack of cyclical variability in the supply of loans to small firms.

There was, however, a difference with regard to large firms. The demand of large firms for funds from banks increased in the upswing and the bank reduced their other assets—but not their loans to small businesses to meet this demand. Now the banks apparently would have been happy to have made these loans to larger businesses earlier, since these loans are more profitable than the investments in Government securities, but the demand from large firms did not exist.

Your tables seem to bear out this hypothesis. There is a very little apparent decline in the loans available to most small firms over the course of the business cycle. Instead the change over the upward phase of the cycle is an increasing absolute amount of funds to large firms with only a very slight reduction in the supply of funds to small firms.

Question 5. Mr. Wilde, I believe your report comes out in favor of what you call "general monetary controls," and does not recommend any selective controls.

Where this seems inconsistent to me is that the Federal Reserve has, in recent years, maintained general tight money when its purpose, in fact, was to influence certain segments of the economy and not to influence all segments.

For example, here is Mr. Alfred Hayes' testimony late in 1957, saying:

"* * * in 1955 you had housing and automobiles at a very high level, and capital expansion fairly high but not anything like we got to later * * *."

"The next year you had a substantial drop in automobile production and a considerable drop in housing, but you had a capital boom * * *."[1]

The Federal Reserve authorities told us at the end of 1957 that the tight money squeeze of that year was aimed at restraining capital expansion. The testimony was to the effect that the Federal Reserve people thought that the building of new plants was going too fast, and consumer demand was not increasing fast enough to keep pace.

Yet, the Federal Reserve followed a general squeeze which contracted consumer demand at the same time it contracted capital expansion.

[1] Before House Small Business Committee, November 1957.

My question is, if the Federal Reserve is going to shoot at specific targets anyway, why not give them a rifle to shoot with, instead of making them use a shotgun which hits targets they do not want to hit?

Answer 5. Mr. Chairman, you will note on page 74 of the Commission's report the statement, "The Commission is almost evenly divided as to the desirability of granting standby authority to the Federal Reserve Board for consumer credit controls. In the absence of a concensus no recommendation is made except to urge an investigation of better forms of such controls which could be administered more effectively if they should be needed." Some Commissioners were against selective controls on philosophic grounds, others on pragmatic grounds that they couldn't work.

On the previous several pages and throughout the section on selective controls emphasis is devoted to the difficulty in designing selective controls which could be effective. I would not hazard what would have been the Commission's recommendation if they believed that effective, efficient selective control mechanisms could be designed. I am sure that the debate would have been vigorous and I think you can gather this from the dissents.

Question 6. In your statement you indicate that open market operations should constitute the primary instrument of monetary policy, and that the discount windows should be only a source of temporary credit. You also recommended uniform lending standards and uniform discount rates for the discount windows:

(*a*) I wonder why it is you decided against having flexibility in the system so that the regional banks can make money easier and interest rates lower, say, in the distressed areas than elsewhere?

(*b*) When the Federal Reserve expands and contracts credit through the open market, this makes more business for the open market dealers, does it not? In other words, when the system expands or contracts credit through the discount windows, the open market dealers do not get any commission or profit on the business?

(*c*) I wonder why it is that the bank lending rates are lower in New York City than the rest of the country? Why is it that bank lending rates in the South and West are always much higher than New York? Does your Commission make any study of this?

(*d*) It is my impression that when a change is made in bank lending rates, the change is always initiated in New York City.

Governor Szymczak testified one time that he had known of only one occasion when banks outside of New York City initiated a change in the prime rate, and that this one occasion was in Chicago. Do you have an explanation for this phenomenon or did the Commission not go into that?

Answer 6. The Commission came out for a uniform discount rate and it also maintained that access to the discount windows should be only as a temporary credit source. The Commission did not believe that a case can be made for flexible discount rates which would permit regional banks to make money easier in distressed areas: I think it fair to say it considered the proposal. As you know a regional Federal Reserve bank must charge the same interest rate to commercial banks who come to it from areas within the region which are distressed and to commercial banks in nondistressed areas within the same region. It cannot discriminate on a price basis between commercial banks within that region; there is no assurance that only those banks in distressed areas would use the facilities of the discount window. Yet as we know we have no distressed Federal Reserve regions. We have distressed cities or distressed areas, several or many within each of the 12 regions of the Federal Reserve System.

The Commission also felt, and much discussion was given to this matter, that the central bank should be primarily engaged in achieving national economic objectives and that the business of supplying funds for special needs of distressed areas should come from elsewhere within the Government. Many recommendations have been made in the chapter on "Federal Credit Agencies" with regard to special access to credit for various types of farmers, for small businesses, for home borrowers, etc. The Commission's belief is that special credit problems should be met through special credit facilities rather than attaching these problems to those of the central banking system.

(*b*) It is true, of course, that when the system expands or contracts through the open market operations, open market dealers are likely to get more business. But expansion or contraction through the discount window is not a substitute for expansion or contraction of credit through open market operations. The great advantage of the open market operation is that it allows the authorities

to take the initiative. The great disadvantage of relying for general changes on the use of the discount window is that initiative lies with the commercial bank members. In some cases they may decide to respond favorably to reduction in the discount rate; in other cases they may not. It would be extremely unfortunate if the use of open market operations to affect the reserve position of the commercial banks, and the level of interest rates, were dropped because of the incidental profits of the open market dealers. These profits, after all, are only a very small part of their income from making a market in Government securities.

(*c*) There are a number of reasons why bank lending rates are lower in New York than in the rest of the country. New York is the central marketplace for financial funds in the country. It is undoubtedly the most efficient financial market; this is where competition gets rugged. Its rates tend to be low because the markup over cost is probably smaller in New York than elsewhere.

The other reason that bank lending rates are lower in New York than elsewhere, and this is particularly true of mortgage funds, is simply a result of supply and demand. The demand for mortgage funds in the South and West is much greater relative to the supply available from these local areas than is true in New York. As a result mortgage funds are drawn from East to West and the difference in interest rates serves the very appropriate function of shifting funds to the sources which are willing to pay most.

(*d*) One of the reasons, and perhaps the major reason, that the change in the bank lending rates, particularly the prime rate, occur in New York before they do elsewhere is that New York provides the alternative of borrowing through the open market. Finance companies—commercial finance companies and sales finance companies—and commodity dealers do not hesitate to sell their own paper in the open market whenever they believe they can get the funds in this market at a rate below the going charge at the banks. As a result their bank borrowing declines. This puts the New York banks under great pressure to reduce their rates if they want to keep the business of these borrowers.

Question 7. Why is it that the Commission recommended that all of the FDIC insured banks be brought under Federal Reserve? Am I correct in thinking this is to bring more bank deposits under the control of the monetary authority?

It seems to me you go in opposite directions when you recommend bringing all of the FDIC insured banks under the Federal Reserve and at the same time recommend dropping all reserve requirments against time and savings deposits.

If you brought all insured banks into the System that are not now in the System, it would increase Federal Reserve control over only $22 billion of deposits. But if you remove the reserve requirements for time and savings deposits of member banks, you lose Federal Reserve control over $108 billion of deposits. In other words, the monetary authorities would lose control of five times as much as they gain. So, I wonder what your reason is for wanting to remove the reserve requirements against time and savings deposits.

Answer 7. The Commission recognized the desire to expand the control over the money supply through bringing more banks under the Federal Reserve System. At the same time it realized that membership in the System imposes a cost for some banks. They must have larger reserve requirements which are noninterest earning, and they must accept checks at par. The Commission also realized that membership in the FDIC gives great benefits to commercial banks. Therefore, it felt that it might be able to draw many more of the small nonmember commercial banks into the Federal Reserve System and enlarge the span of control over the money supply by requiring that any insured bank belong to the Federal Reserve System (see pp. 76–77). The purpose of bringing more banks into the Federal Reserve is to gain added control over variations in the money supply in the form of demand deposits in the commercial banks.

The Commission, it is true, recommended dropping all reserve requirements against time and savings deposits. There were two reasons for this. It was felt that if the Federal Reserve had adequate control over the money supply it would not need, in addition, reserve requirements against time and saving deposits. Now it is true that shifts between time and savings deposits on the one hand, and demand deposits on the other, present a problem for monetary management. But this is easily manageable now. We believed it better to attempt to control these shifts or to react to these shifts through open market operations, rather by having a reserve requirement against time and savings as well as against demand deposits.

But the other, positive reason for dropping the reserve requirement against time and saving deposits is one of competitive equality. The commercial banks would be able to better compete against the other institutions who sell claims very much like their own time and savings deposits, particularly the mutual savings banks and the savings and loan associations. In general any reserve requirements to which these institutions are subject are much lower than those on the time and saving deposits of commercial banks, and even then they can invest their reserves in income earning assets. In contrast the commercial banks are at a disadvantage on two counts. They must hold reserve requirements, which are larger than those of other institutions offering similar claims, and they must hold these reserve requirements in the form of assets which do not earn interest.

Question 8. (*a*) Mr. Wilde, what was the Commission's reasoning in recommending removal of all reserve requirements against time deposits? In the banking system today, are not demand deposits just as safe as time deposits and, if so, should not reserves against time deposits be as high as reserve requirements against demand deposits?

(*b*) May I call your attention to the fact that one prominent school of thought holds that the important factor to be concerned with, from the standpoint of stabilization and monetary controls, is the factor of spending, not just the amount of bank deposits, which may be more or less idle.

I should think, then, that from the standpoint of effective monetary controls you would be interested in the rate of spending of bank deposits. The Federal Reserve reports that the annual note turnover of demand deposits in New York banks was 60 times.

In 6 other leading centers the turnover was 34.8 times. In 337 other reporting centers the turnover was 25.7 times. In other words, demand deposits in New York City were used to effectuate almost twice as much spending as the demand deposits in 6 other large centers, and almost 3 times as much spending as the demand deposits in 337 smaller cities.

Then, for the country banks we know the turnover rate is very low. These deposits are used much like time deposits. Yet, while you are recommending that the reserve requirements againt time deposits be dropped, you are also recommending that reserve requirements against demand deposits be made uniform for all cities and all classes of banks.

How did the Commission reconcile these two recommendations which seem to go in opposite directions?

Answer 8. (*a*) With regard to question No. 8(*a*), I hope I have answered it in my answer to No. 7. Demand deposits, it is true, are just as safe as time deposits to the extent that both are insured, and to the extent that banks remain solvent. The similarity in the degree of safety of both classes of deposits does not lead to the conclusion that reserves against one should be as high as the reserves against the other. The purpose of reserves against demand deposits is for leverage in the control of the money supply (p. 68)—safety is provided by deposit insurance.

(*b*) The Commission was very concerned with the effectiveness of monetary control and it considered at some length whether the variation in the rate at which bank deposits were spent would tend to frustrate monetary control. For this reason it recommended extension of control over that part of the money supply created by nonmember banks by attempting to get them into the Federal Reserve System. But it also thought that if the authorities had adequate control over the money supply they would not need control over financial claims created by nonbank intermediaries and even over the time deposits and the savings deposits of the banks themselves. After all, no one can spend these claims—they have to be exchanged for money—and the money must come from some place, which means that, if the supply is fixed, someone else can't spend it.

I do not think that the recommendations for the elimination of the reserve requirement against time deposits and the recommendation for the uniformity of the reserve requirement for member banks in all cities and for all classes of banks are in contradiction. The first is not concerned with the management of money supply as such, as I've explained above. The second is concerned with monetary management. If the reserve requirements are equal for all banks, both the country banks and the reserve city banks, then shifts of funds between one set of banks and another should not lead to any need for compensating action by the Federal Reserve authorities.

Question 9. I have asked a number of Federal Reserve authorities about this, and a number of private bankers, too, and they all tell me this:

Reserves against demand and time deposits are commingled. In other words, member banks compute a single required reserve, and this is a weighted average of time and demand deposits. So, the result is that reserves against time deposits can be used, and are used, by the banks to create new money and to expand their demand deposits.

So the result would be the same if you recommended keeping the requirements against time deposits and recommended, instead, lowering the requirements against demand deposits—can you disagree with that?

Answer 9. It is true, as you say, that banks commingle their reserves against demand and time deposits and that they have a single required reserve which is determined as a weighted average of time and demand deposits. Now imagine what happens when a bank receives a new time deposit. The funds deposited can come from several different sources. They can simply be drawn against their demand deposits; they can be drawn against the demand deposits of other banks; they can represent a transfer from the savings deposits of other banks, or of savings banks and savings and loan associations, and they might even come through a reduction in the public's holdings of cash. These switches cause a change in the free reserves of the member banks, when there is a reserve requirement against the time and savings deposits in the member bank. The situation would not be significantly different in the absence of a reserve requirement against time and savings deposits, except for the magnitude of the change in free reserves.

Now it is true that identical requirements for time deposits and for demand deposits would reduce the need for compensating change in open-market operations in response to these shifts. But if this result were approached by reducing requirements against demand deposits to the level of those against time deposits, then the excess reserves of the commercial banks would be very large. And if it were accomplished by raising the reserve requirements against time deposits in the commercial banks, then we would find their ability to compete with the other financial institutions which create claims much like time and savings deposits greatly reduced.

Question 10. Also, you recommend removing Federal Reserve control over maximum interest rates the commercial banks can pay on time deposits. The reason given here is to give the commercial banks equality with the savings and loan associations and the mutual savings banks, in competing for these deposits. Yet, the fact is that with a dollar of time deposits a commercial bank can make about $20 in loans and draw interest on about $20.

This being true, why can't a commercial bank afford to pay 20 times as much interest on a dollar of time deposits as a savings and loan association?

Answer 10. I differ with your statement of the problem. When a commercial bank has an increase in its time deposits of $1, it can make a new loan of about $1. Actually since it must increase its reserves, it may feel that it would be safe in making new loans of only about 90 cents. If it attempted to make a new loan of $1.10, it would very shortly exhaust its cash balance. In this manner the bank is no different from you or me. It simply can't make new loans in excess of its excess money holdings, without selling other assets.

Now it is true that as a result of being able to make a new loan of 90 cents will put funds of this amount back into the income stream and someone else will make a new deposit of 90 cents in some other bank. This bank in turn can lend a large amount of this new deposit. Your statement fails to distinguish that what the banking system as a whole can accomplish, one bank individually cannot accomplish. Therefore, I disagree with your conclusion that a commercial bank can afford to pay 20 times as much interest on a dollar of time deposits as a savings and loan association.

Question 11. In your statement you say the Commission saw no reason to object to the use of monetary controls because of their effects on income distribution.

This is a problem which has long worried me. During periods of poor business and high unemployment, the Federal Treasury runs a deficit and the Federal debt is increased. Ideally, we should pay off some of the debt in good times and high employment. But when the business cycle turns upward, the Federal Reserve increases interests rates and the funds which might be collected in taxes to help pay the debt go, instead, into increased income to the interest-income receivers.

I wonder if the Commission gave any study to this problem and has any recommendations as to how we can pay off some of the debt in good times, instead of diverting income into interest-incomes in such periods?

Answer 11. As interest rates go up during the business upswing, people who pay interest and can treat it as an expense have a lower income; the people who tend to receive interest have a higher income. From the point of view of the tax collector, Peter has a lower taxable income and Paul has a higher one. I don't see how this decreases the amount of taxable income, although it does somewhat tend to change the names of the people who pay the taxes.

The Commission, as you know, felt that we should have a contracyclical fiscal policy and that the Government should incur debt in poor times as a means of stabilizing income and employment.

Question 12. In your statement you say that no seemingly effective control has yet been devised for regulating business credit. Furthermore, you say that the Commission suggests that methods for this be investigated by the Government.

What agency of the Government do you believe should get the answer to this question, for which we were hopeful, at least some of us were hopeful, that the Commission on Money and Credit would supply?

Answer 12. The Board of Governors of the Federal Reserve System, together with the regional Federal Reserve banks would surely be the logical agency to make a further investigation of the methods for regulating business credit. Perhaps other Government agencies might participate. It is conceivable that the Treasury should be able to contribute to the study. Your own committee might even sponsor some studies by academic scholars.

Question 13. You say that the building and loan associations and mutual savings banks are sources of escape from the impact of monetary control.

Have you found that these thrift institutions are acting as depositories and keeping large amounts of cash in their vaults? Are all of their funds on deposit with the commercial banks?

Answer 13. None of the evidence that the Commission investigated suggested that thrift institutions keep large amounts of cash in their vaults, larger than the amount necessary for their day-to-day working balances. Almost all of their money balances are on deposit with the commercial banks. These balances, of course, comprise only a part of their liquid assets awaiting permanent investment, since such funds are frequently invested in income-earning short-term Treasury bills.

Question 14. You state again that the Commission has recommended that all insured commercial banks should be required to become members of the Federal Reserve System.

No doubt you know that this requirement was in the original FDIC bill but was taken out in committee. I believe that the chairman of the House Committee on Banking and Currency later testified that the committee had to take it out in order to get the FDIC bill passed.

It seems that all bankers were against it. Those banks who were not members of the Federal Reserve did not want the provision; and the correspondent banks who are members also did not want the provision, because as matters stand they are, in effect, the Federal Reserve banks of the nonmember banks; and it is very profitable for the correspondent banks to operate as banker's banks.

This has continued to be the source of the opposition to increased membership in the Federal Reserve System; the correspondent banks agitate and propagandize the nonmember banks against joining, and both the member banks and the nonmember banks put up a united front to Congress.

I wonder if your Commission gave any thought to ways whereby this uniform opposition in the banking fraternity can be overcome?

Answer 14. The Commission did consider the problem of bringing all the insured commercial banks into the Federal Reserve System. (See my answers to questions 7 and 8.) Indeed one of the reasons for requiring all insured banks to be members of the System was to induce anyone who wished the advantage of insurance to bear some of the cost of belonging to the Federal Reserve System rather than being free riders.

If you look at the composition of the Commission you will note that some of its members were from the banks which hold sizable balances of nonmember correspondents. Even though their own bank's business in this regard would be somewhat smaller, they felt this change to be a desirable one from the national point of view. I do not feel that their position was unusual in this regard.

Chairman PATMAN. I would like to go over some of this with you. You mention taking off the requirement concerning the Federal Reserve fixing of the interest rates on savings of the commercial banks. Did you make any recommendation about interest on demand deposits?

You recall in 1935, under the act at that time, it was made unlawful for banks to pay interest on demand deposits. One of the members of the Federal Reserve Board testified before the House Small Business Committee about a year or two ago that this law had been ignored and should be repealed; that it is known in the breach, rather than in observance. What is your observation about that?

Mr. WILDE. Mr. Chairman, the Commission discussed those aspects quite thoroughly and were of the opinion that there should be no change. Therefore, while it is not mentioned here, that arises out of the Commission's operating technique that we did not mention things unless we were advocating change.

I do not believe the Commission had the impression that there was any large degree of action that was in contravention of the intent of the banking authorities that there be no interest allowance on demand deposits. It certainly did not come to the attention of the Commission.

Chairman PATMAN. Is it not rather unusual for bankers to advocate regimentation? It is regimentation of a drastic sort, to say that bankers, in private enterprise, cannot pay a customer for the use of his money.

In other words, the banker is restricted in his ability to contract with the customer. The law says you cannot pay him for the use of something that is useful to the bank.

Do you not think that is going rather far in that direction, Mr. Wilde?

Mr. WILDE. It could be argued as somewhat irrational. But, Mr. Chairman, it seems to me that a bank is a rather unique institution. It should be given maximum flexibility in its operations to serve the public in the broadest way. But at the same time it is a type of institution that society feels has to have some regulation, as I see it.

Chairman PATMAN. And on the theory that it needs regulating is the reason?

Mr. WILDE. Yes.

Chairman PATMAN. You mentioned that the discount rate should be uniform throughout the country. Did you hear my interrogation of Mr. Eccles on that point yesterday?

Mr. WILDE. Mr. Chairman, I am sorry to say I only heard part of it and I do not think I heard that particular section.

Chairman PATMAN. I can make it very short.

The law is very plain, the way I read it, that the Directors of the 12 Federal Reserve banks have no power to establish the discount rate. I think the Federal Reserve—that is my personal belief—the Federal Reserve Board has been going beyond that on the theory that it makes them feel like they are doing something useful, but over which they have no power or authority.

I think the law was written that they must pass on that every 2 weeks so that the Federal Reserve Board could, every 2 weeks, establish the rate as the Federal Reserve wanted to. Now, there is no dispute that the Federal Reserve Board can establish that rate at any rate they want to for all 12 banks. You agree with that, do you not?

Mr. WILDE. Yes, sir, that is my understanding.

Chairman PATMAN. So I cannot understand why you spend so much time recommending things already in the law. It is the law right now.

Mr. WILDE. I would not pose as so familiar with it as Marriner Eccles, but my concept of what the Commission is recommending is merely simplicity of administration rather than any substantial change.

Chairman PATMAN. I understand.

Now, then, there is a big difference in interest rates in the West, the Southwest, the South, and New England and New York. Can you tell me any reason why those differences should be there when the Federal Reserve is using the credit of the Nation in all the 12 Federal Reserve districts. If the Federal Reserve System is going to influence interest rates and monetary policy, why should not the rates be uniform? Why should the South and West have to pay an additional 1 percent and even more on mortgage loans than they have to pay in New York and New England?

Mr. WILDE. Mr. Congressman, it so happens that having been connected with an investment organization for 40 years, I am somewhat familiar with the phenomenon that you speak of and the change has been spectacular.

Money has flowed across this country from the days when the rate in Boston for a mortgage was 5 percent, to the rate in South Dakota, when it was 10 percent, so that I think you are right in saying that there is a differential, but it has narrowed down to the area of perhaps less than 1 percent. I would say 1 percent was a high spread today.

Chairman PATMAN. I am talking about mortgage loans.

Mr. WILDE. Yes, sir. Well, the reason for that remaining spread is because, after all, mortgage loans are furnished by local institutions, and so far more money has been saved in the older parts of the country than in the newer parts of the country, and the national organizations spread out and they come into those markets, but they are able, because of the demand relative to the local supply, to get some differential.

But I would not say it was more than about half of 1 percent, Congressman.

Chairman PATMAN. Well, in business loans you are correct. It varies from about one-half of 1 percent to a maximum of about three-quarters of 1 percent on business loans.

But I think on mortgage loans, on construction and homes in particular, that you will find that 1 percent is a reasonable estimate.

Now, you know more about it than I do because you are in the business.

Mr. WILDE. There is another aspect of it I just remembered. Certain borrowers would like to have a larger loan and are willing to pay a higher rate for it, so that in some of the newer parts of the country where people are perhaps more optimistic about their future, if they can borrow 90 or 100 percent on a new home, they will pay 6.5 or even 7 percent, when they could get money for 5.5 or 6 percent if the loan to the apparent value—this is on guaranteed loans—was satisfactory to them. That enters into it.

Chairman PATMAN. Yes, sir. Now, is it generally customary among commercial banks now to require a borrower to leave on deposit a minimum of, say, 20 percent of that amount that he borrows?

Mr. WILDE. Is it customary?

Chairman PATMAN. Customary; yes, sir.

Mr. WILDE. I believe it is. I think it is not always literally followed by a bank, but I think it is a general and customary procedure.

Chairman PATMAN. The effect of it, of course, is to cause the borrower to pay an increased interest rate equal to about 20 percent more; is it not?

Mr. WILDE. If it is fully executed.

Chairman PATMAN. Yes, sir.

Now, did your Commission make any study of whether or not the banks are carrying out their obligations to the public in the area they are chartered to do business?

I refer specifically to this. Way back before the Federal Reserve, the record will show, that most of a bank's business came from the local area where it was chartered to perform banking duties. At that time the local laws provided that directors of banks had to live within that area. Later on they began to change it to where one director could live more than 50 miles away. After a while they fixed it so that directors could live in other States, and they changed it to where now it is not wholly in control of local people except, perhaps through dummy directors, we will say.

It seems that at the same time the business of the banks has drifted away from taking care of local people where they are giving this wonderful opportunity to manufacture money on the credit of the Nation to use locally to help in the progress and development of the community and for the convenience in serving the people of that community. They have gotten away from that.

They do not serve the small business people so well any more, and they have just neglected the farmers to where the Government has had to set up special agencies to take care of farm loans. The commercial banks just quit serving them.

Now, the commercial banks even in small towns use a large part of their lending ability, by investments in outside bonds, U.S. Government bonds, even tax-exempt, long-term securities.

Did your Commission look into whether or not the banks are adequately serving the communities where they are chartered to do business?

Mr. WILDE. Yes, sir.

One of the task forces addressed itself to that problem in its broad essence, Mr. Chairman.

They found that it would be useful if the total financial institutions in the country were expanded. They took no sides between what particular ones, whether it was commercial banks, whether it was chain banks, branch banks, or chartered mutual savings banks, but they said that the total banking accommodation of the country should be expanded in various forms so that there would be more places where people could make deposits, and there would be more places where people could go and borrow money.

And they went so far as to recommend that the authorities be very open in granting charters even if it were not perfectly clear that the

bank unit, whether it was a branch of a bank or whether it was an individual bank, could make money.

They said, in effect: "Let us broaden the facilities for the public."

So that there was a very categorical, across-the-board recommendation in respect to the general question you asked, Congressman.

Chairman PATMAN. I know, but you started off by saying "expanding the opportunity of these institutions to make loans," I believe.

Mr. WILDE. To receive deposits and make loans.

Chairman PATMAN. Yes, sir.

We have had a little experience in that. One year I remember that the Federal Reserve in lowering the discount rates over the country permitted the banks to expand their credit about $10 billion, and they put every bit into Government bonds. Not a penny went to small business or anybody else. They just bought U.S. Government bonds. Now, that does not help the country too much. It does not help the people generally for commercial banks to buy Government bonds. It does not help anybody.

I would really restrict the commercial banks in the purchase of Government bonds, myself. I would not mind their having a certain amount for secondary reserves, but to just go in the business of being Government bond brokers, I think is terrible. They are making a large part of their earnings just on riskless Government securities, now, and I think that is bad. Do you look with favor on that?

Mr. WILDE. I do not want to comment on the way the other fellow runs his business because I am not sure I always do the best job I should do. I will say this: I think it is the function of a bank primarily to furnish funds for trade and commerce and not to invest the money just to receive interest on it.

But I think most of the banks are pretty aggressive today, those that I am connected with are very aggressive, and would much prefer to make a loan to a businessman than to buy a Government security, and, in fact, we have sold Government securities at a loss in order to make business loans.

Chairman PATMAN. Primarily the obligation of the bank is in the area where they are charged to do business, is that not correct, primarily?

Mr. WILDE. I think so, yes, sir.

Chairman PATMAN. Mr. Reuss, would you like to ask some questions?

Representative REUSS. On the Commission's observations on growth in the money supply, I have a couple of questions.

The matter of growth in the money supply is not entirely within the control of the monetary authorities, is it? That is to say, if businessmen do not want to borrow, you can make credit very easy but businessmen will not borrow?

Mr. WILDE. That is right.

Representative REUSS. Therefore, should not the focus of governmental monetary policy by the money managers be to a very considerable extent in times when expansion is needed on the provision of the so-called free reserves? That is one thing they can do. The money authorities can provide free reserves. They cannot, alone, increase the money supply.

Mr. WILDE. That is correct, sir.

Representative REUSS. I have been struck over a period of time that even though free reserves are provided, there does not seem to occur in the sale of money the phenomenon that is supposed to occur in the sale of commodities: namely, the price goes down when there are not many purchasers.

What do the researchers of the Commission have to say on that point?

I have observed that interest rates are sticky. One would think that with plenty of free reserves, a high rate of unemployment, and less than full use of our resources, interest rates would tend to go down, thus encouraging businessmen to borrow.

This has not happened to the extent that Adam Smith claimed it should happen, and I wonder what the Commission observed on that?

Mr. WILDE. Congressman, the phenomenon of our economic activity, as you realize, is very complex, and there are very large elements of the intangible and of the human in it. The first instinct of a businessman and of many individuals is to do something that looks profitable or useful to him.

But if he is concerned about the general environment, he does not necessarily do it. A businessman does not add to his inventory if his guesstimate of the future is that perhaps prices are going down and he can buy his inventory for less money. The fact that the bank, contrary to what they might have said to him 6 months ago, "John, don't you think you better hold back and not add to your inventory," they may now have called him up and say, "Why don't you buy?"

But on the boomside, the businessman usually follows his own judgment and on the other side he follows his own judgment. The mere fact that he can borrow money does not mean that he will do it.

More importantly, in the expansion of plant and equipment, the wise thing to do would be to borrow the money and build your plant when folks were out of work because they will work more effectively.

You can buy your materials better and you will be ready. But it just does not happen. The human element gets into it, and the factor of exaggerating the swing gets into it. But it is not as bad as it used to be.

There is more long-range planning and more going forward with projects that are going to be needed even in times that are not as favorable.

I think that is one of the reasons why the fluctuations in the last 10 years have not been as severe as they were historically.

But, as we said in our introduction, this involves the basic conduct of humans. These measures are mechanics that help humans carry out what they want to do but do not make them do it, especially on the upside. They restrain them on the downside more than they push them on the upside.

Representative REUSS. I would agree that there may be circumstances in a deep depression, let us say, when even if moneylenders were willing to lend money at zero interest, businessmen would not feel like borrowing because they sense prospects are poor, and, after all, you do have to pay the principal back.

But my specific question related to the last year, when there was a considerable recession and unemployment, a rate which even now

is almost 7 percent of the work force, where there was a provision by the "Fed" of free reserves on the general order of half a billion dollars at any one time, and where the rate of interest on bank loans went down very little, if at all.

My question was:

If interest rates had been more sensitive to the abundance of supply of credit and the relative paucity of demand for credit, might they not have gone down more than they did, and might not this have stimulated marginal businessmen to ask for credit and do something useful with it to a greater extent than they did?

Mr. WILDE. I would think that the answer would be "Yes," to a degree. But you will recall that in the development of business there are two kinds of money used. There is the bank money and there is the savings funds. Most projects involve capital funds, savings funds, whether they are in that type of institution or wherever they are.

You do not borrow money from a bank to build a new plant, even if the rate was much lower than it is, unless you have a take-out of long-term funds or retained profits coming, and there was not any abundance of long-term money.

The threat of inflation may be a subsidiary factor in that. I think the real factor is that the savings habits of this country are not high. They run, as you know, 7 or 8 percent, and the total savings in comparison to the total demands for long-term capital are very close.

As a result, rates for that kind of money have been firm just by the old rule of supply and demand, even with a somewhat lower demand. But the demand has been somewhat greater than one would anticipate.

Bank ranks, those I have seen, have been off perhaps as much as one-half of 1 percent but not as much as one might anticipate, as you say, from the redundancy in reserves.

Representative REUSS. Of course, bank finance, particularly since World War II, has approached a middle ground between short-term inventory financing and long-term capital financing, your 10-year-term loans and intermediate-length credits of that nature, which do have something to do not with building a factory, let us say, but with purchasing tools and equipment for the factory.

Mr. WILDE. Yes. You are quite correct, and they are quite substantial in the banking structure. But they are all subject to take-outs without penalties. The borrower usually intended to go to the permanent capital market when he thought it was right. He was speculating on rate structure in making a term loan at a bank generally, because he does not usually anticipate ability to earn enough money to pay off a term loan.

Representative REUSS. In 10 years?

Mr. WILDE. Yes.

Representative REUSS. However, he is prepared to sign the term loan for 10 years, and I should think that the propensity to invest of a businessman, large or small, would in some measure reflect the amount of money he has to pay during that 10-year period. After all, 10 years is a long time and he may hope for a lower plateau of long-term rates by that time due to higher national income, more saving, etc., etc.

Mr. Wilde. I have been a lending officer for about 25 years, if you will pardon a personal injection, and it has always appeared that the borrower was influenced in this order:

(1) He wanted money for something that he thought would be profitable or useful to him.

(2) He usually wanted the maximum amount he could get. That is relatively new. In the older days people borrowed pretty conservatively. But in the last 25 years what we used to call in lending circles overborrowing is the common thing.

(3) And the third thing is the rate.

I agree that rate has something to do with it, but it is the opportunity that a man sees to build a building, expand his plant, build a home, as far as that is concerned. "How much money can I get on it?"

And, third, the rate. As a lender, the borrower always asks you, "Can't I do better?"

But if the first two things meet his ambitions, he will go ahead regardless of rate and he will borrow more money generally in optimistic boom times than in poor times, when he could get the money for at least 1 percent less. That is the way life has been in my experience.

Representative Reuss. A good part of your quarter century of experience as a loan officer has happened, through no fault of yours, I hasten to add, to coincide with the period of rising prices in this country, and this, no doubt, has entered into business psychology.

After all, if business is going to be good, prices are going to go up. The difference between paying 4 and 5 percent on a 5-year loan does not seem to be very large in the total.

Mr. Wilde. Along with the help in Washington of high income tax on corporations and individuals, lowering the cost of money.

Representative Reuss. If the economy carries out the recommendations of the Commission on Money and Credit and has a generally more stable price level in the next 25 years than we have had in the past 25, I should think that the interest rate charged on loans might be a more meaningful consideration in the future than it has been in the past.

Would you agree with that?

Mr. Wilde. I think it might be. But, as you know, in many businesses the idea is to have high involvement in debt so that your equity can turn over fast and make a lot of money for your business. You can finance your equipment, which never used to be done, as well as your building and so forth; then the residue of equity can show a high return to the stockholder owner even if you are paying 6 percent on this large amount of fixed assets.

It is a relatively new concept of how you can successfully run a business, and I do not think that has been observed as much by some of the economists as I have observed it as a lender.

Representative Reuss. Are you suggesting that the deductibility for income tax purposes of interest paid has made the payers of interest somewhat more cavalier about how much they get charged?

Mr. Wilde. I think it has been a contribution to that, but, also, the fact that if you are running a rapid turnover business, I think perhaps some of the store businesses turn over their inventories 15 times or more, you see, the fact that you pay 6 percent for selling your build-

ing and get 100 percent on it and your equipment, you see, it works out very well on the leverage basis.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you, Mr. Chairman.

As a member of the Housing Subcommittee, I have heard the charges of the builders for the last several years that in boom times they have been forced to walk the plank and in recession they have been the restart of the boom.

Now, from the Commission's study, I take it that you agree that this is true?

Mr. WILDE. We agree that it is true to an extent. I do not know that I quite agree with the statement as you phrased it, but perhaps we are saying the same thing.

Representative GRIFFITHS. Also, from your statement you seem to think that it is not an undesirable policy; that it has been the policy of the Government and that it is not an undesirable policy?

Mr. WILDE. Yes.

Representative GRIFFITHS. You say:

> The Commission believes, therefore, the psychological impact has not been undesirable.

Do you think it is necessary?

Mr. WILDE. Are we not dealing here with this broad problem of whether stability is more useful than instability, because in one area housing is such a vital, human thing. If you approach it from that standpoint, it is undesirable. If you approach it from overall stability of the economy, I think you have to say, as the Commission said, that it is desirable to have some restraints on building booms, because, as you probably know, this does happen.

If you get a big building boom, the price of construction goes up pretty fast, because that is an area where there can be shortage of workmen as well as material.

And it is questionable whether that is good for the consumer. Might he not be better off to have to wait a year or two and get a better value?

Representative GRIFFITHS. Can you control the policy sufficiently to stabilize the housing market?

Mr. WILDE. Can you control it?

Representative GRIFFITHS. Yes.

Mr. WILDE. You can control it, as the Commission says, by asking the principal authorities that influence building in the governmental sector, VA and FHA, to alter their credit terms. Credit terms, including interest, have a very large impact on the rate of residential construction.

Representative GRIFFITHS. Can you control the monetary policy sufficiently to force this type of distress upon another group other than that of housing?

Mr. WILDE. We cannot without selective controls.

Representative GRIFFITHS. You point out, and you recommend—you suggest that a 25 percent gold reserve be set aside so that all the gold is available for the payment of international obligations.

In view of the fact there are quite a few people in this country who still think we should return to the gold standard, would you explain

in detail now or later, if you choose, the effect upon the monetary supply in this country of such a reduction in gold supply?

Mr. WILDE. This is a question of subtlety and of human psychology, as I see it. As you know, the tendency in this country and other countries over the years has been to lower reserve requirements, particularly when the reserve was valuable metallic gold, under the general theory that it was not necessary to have as much coverage, and, finally, in some countries no specific coverage.

It is a characteristic of humans not to want things if they can get it, and I think that is partly involved in this recommendation of eliminating the 25 percent reserve requirement. You can say to foreign holders of balances, "You can get gold, if you want it."

We are not restricted to just $6 billion; we have got $17 billion; they are less likely to want it. It is the same theory about a bank run.

Representative GRIFFITHS. I am not particularly interested in that part of it. But what would be the effect upon our money without the gold reserve?

Mr. WILDE. The effect on our own money?

Representative GRIFFITHS. Yes, within our own economy.

Mr. WILDE. I do not think it would have any important effect as other lowering of our reserve requirements have had very little effect.

Generally, people have confidence in their money or lack confidence in harmony with the general state of the economy. You can have a higher gold reserve, but if the people are apprehensive about the course of prices and think that we are going to have inflation, since they are not able to exercise the direct discipline of gold which we used to have, then the reserve is, to me, largely academic.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Thank you very much, Mr. Wilde.

You will receive the transcript, and if you will answer those questions, I shall appreciate it.

Mr. WILDE. Mr. Chairman and members of the committee, may I thank you on behalf of the Commission.

Chairman PATMAN. Mr. Leon H. Keyserling. Mr. Keyserling was chairman of the Council of Economic Advisers at the White House for a number of years.

I happen to know that Mr. Keyserling had a lot to do with the drawing and the presenting of the act known as the Employment Act of 1946.

I will state something that has never been stated before, Leon, with your permission. There were many meetings on Capitol Hill about that bill on the Senate side and the House side, and after many, many conferences the bill was finally agreed upon as the Full Employment Act, and at that time we were shooting for a goal of 60 million employed.

I believe some of the different groups had stickers, "Full Employment—60 Million."

We had a terrific fight in both the House and Senate before the respective committees, and I believe that it can fairly accurately be said that about the only change that was made in that bill that you had so much to do with was changing the word "full" in "full em-employment" to the word "maximum"—"maximum employment".

So it is very much today like it was finally agreed upon before it

was even presented as a bill in the House and Senate. I want to express my appreciation to you for the fine public service that you have rendered throughout the years. I happen to have knowledge of your service from long before 1946, and I personally appreciate what you have done, and I am glad that you are still engaged in that type of work.

We are delighted to have you, sir, and you may proceed in your own way.

STATEMENT OF LEON H. KEYSERLING, CONSULTING ECONOMIST AND ATTORNEY, PRESIDENT OF THE CONFERENCE ON ECONOMIC PROGRESS, CHAIRMAN OF THE PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS, 1950-53; ACCOMPANIED BY LAWRENCE A. LEONARD, ECONOMIST

Mr. KEYSERLING. Mr. Chairman and members of the committee, I certainly want to thank the chairman for what he has just said about me. For almost three decades, I have known him and admired greatly his wonderful public service in many fields. I also appreciate the opportunity to present my views on the monetary policy section of the widely heralded Report of the Commission on Money and Credit, published earlier this year.

I do not want to create the impression as I go along that I am wandering away from the subject. So as I was sitting over at the table, I thought of a little analogy. If I as a hospital expert were asked to go into some new hospital and render an opinion upon its utility, and I came back and said, "Well, in the first place, some of the corridor turns seem to be too narrow to get the wheelchairs around them very well, and, in the second place, the hospital has no operating room," and then somebody said, "Well, the first criticism is valid; but you really cannot talk about the second because you were asked to look at what is in the hospital, not at what is outside the hospital."

Similarly, my main criticism of the Commission report is that it does not focus, in my judgment—I will not repeat "in my judgment" in each case but everything I say here is only in my judgment—it does not really focus on the big issues.

It does not really analyze the big problems, and, therefore, it does not really address itself to the big issues of policy.

I want to state most emphatically that my testimony is addressed to the body of the Commission report as a whole. Throughout the report, there are numerous dissents in the footnotes which I esteem most highly, and indeed which indicate that many of the sentiments which I shall express were shared by some members of the Commission. But these dissents are scattered throughout the report; they are not consolidated into a unified nor continuous framework; and therefore they cannot sufficiently counteract the unfortunate impact of the report as a whole. And even the dissents, for the most part, being addressed to the content of the body of the report, cannot and do not introduce sufficiently the type of essential approaches which I think the report so grossly neglects.

Within a generation, the American economy has come through periods of peace and war, prosperity and depression, inflation and deflation—at times extreme and at times moderate. From all of this

vast and varied experience, we should be able to learn much about how the instruments of economic policy of a free people have actually worked, what good and bad results they have accomplished, and consequently how they might be shaped more effectively to deal with the tremendous economic problems still confronting us in an age of worldwide peril. Our efforts should be great, because our problems are great and our perils are great.

I therefore thought that this widely financed and highly staffed endeavor would take the $500 billion laboratory of the American economy, look at how it was functioning during the past periods to which I have referred, measure the quantitative and qualitative impact of various policies upon how it was functioning, and thus decide what things had been done well, what things had been done poorly, and use this as a guide to measure considerations as to improvements in monetary policy and also in other economic policies.

But the Commission on Money and Credit, in my considered view, has said nothing in any great perspective; it has offered little that is novel, and little indeed that is useful in terms of and relevant to our great problems. Instead, it has issued, for the most part, a pedestrian handbook of theoretical and rather conventional economics, suited to an introductory course in the subject; specific analysis of why so much has gone wrong in our economic performance, as a guide to improvement, is almost nonexistent; and the specific recommendations, some good and some bad in themselves, are almost entirely picayune and secondary—with respect to monetary policy. I say, in all due respect for and admiration of the last witness, that on the few questions which were asked with respect to a specific judgment on specific matters, the general impression given was, "Well, there are things to be said on both sides, and we really cannot quite take a position on it yet."

I am speaking here especialy of the monetary aspects.

In the very nature of the subject with which economics deals, the big problems and the big solutions are controversial because they touch on big interests; they, therefore, require courageous approaches; and a report which is surcharged with timidity throughout and equivocation and compromise in many places suffers accordingly.

It will be said that all of this and no more might have been expected to result from a study initiated and organized as this one has been, making it virtually inevitable that the results obtained would sink to the lowest level compatible with areas of easy agreement among well-mannered people of widely divergent views and widely unequal equipment for the tasks assumed.

I do not deny the high value of enlarging the areas of agreement in a democracy, nor the value under many circumstances of bringing together just such a group for just such purposes. But it should always be remembered that the forces which gathered originally to initiate this study and to finance it were associated in substantial numbers and influence with the proposition that a group of this kind would be more objective and therefore more entitled to be entrusted with a study of this magnitude and significance than some sectors of the Congress of the United States.

I do not regard this incident as an enviable embodiment of the democratic process, but, rather, as a prime example of why, in my opinion, we should place more stress upon utilization of constituted

public authorities to investigate and review the great national issues with which they must finally deal. And for this very reason, I salute the congressional Joint Economic Committee for holding these hearings, and earnestly hope that they will provide a vehicle for applying some correctives to judgments which otherwise might be formed by those who read the report and recommendations of the Commission on Money and Credit, and take them for more than they are worth.

Now, I would like to follow the procedure of looking briefly at what has been happening in the American economy over an important period of time; then endeavor to trace how this experience is surcharged with lessons for monetary policy; and then examine how the recommendations of the Commission either do not address themselves to these matters or in the important aspects where they do so address themselves, at times offer or imply the wrong answer, or evade these large matters entirely and deal with small tidying up of certain aspects of the administration of an important system without addressing themselves to the larger question of what the monetary policy is for and how it has worked and what it should do and how the great instrumentalities of policy should be directed toward making it work better.

At this stage, I have some charts, which I shall use to analyze how the economy has been working, how monetary policy has worked, and of how the Commission on Money and Credit has performed.[1]

First of all, let us start with the ending of the Korean war in 1953—and I picked this starting point because the ending of the war removed the galvanizing pressures of wartime, and I think great mistakes have been made from improper analogies between wartime and nonwartime periods. We are not in a war now. We are in a situation with a high level of national defense, but we are not in a situation similar to wartime. Since the ending of the Korean war, as we all know, the American economy has come through several complete cycles of short-lived booms, stagnations, and recessions.

On the first chart, with which you are thoroughly familiar, the bottom sector of the chart shows, year by year since 1953, how the economy has moved, up and down and sideways, and, as you know, for a number of years I have tried to develop the idea that this had become a confirmed pattern in the American economy: A short upturn, a period of stagnation, and then a period of downturn.

And may I say that, in my view, the upturn in which we now find ourselves, like the upturn after the three previous recessions, or two previous recessions since 1953, is similar in its content and is likely to be similar in its ultimate course, except that it is somewhat more moderate than the others. Within this long-range pattern, each upturn has carried not quite as far as the previous one; each downturn has carried a little further; and, therefore, in the long run, regardless of the upturns and the downturns, we have accumulated vastly cumulative amounts of unemployed plant and manpower. Idle plant and idle manpower are, of course, the primary indictment of any economy, in economic terms, and not just as a human consideration.

Charts 2, 3, and 4 show the costs of this idleness, in private and public terms.

[1] Charts 1–12 appear below at pp. 113–124.

The fifth chart, which I will not linger on, partly because I have shown it to this committee before, except that I brought it up to date, shows not only that we have more unemployment in periods of recession than in periods of upturn but that in the "boom" year 1959 we had vastly more unemployment than in the "boom" year 1955.

And, not only that, we had as much unemployment in 1959 as in the recession year 1954.

The sixth chart shows unemployment in various other aspects.

Now, turning to the seventh chart, which is new, I have undertaken to show unemployment in the various sectors of the economy, because of the unfortunately prevalent idea that this rise in unemployed manpower is a segmental thing or a specialized thing.

I remember how I inveighed in the years past, when we were told that those unemployed in agriculture would find jobs in industry, and then we were told that those unemployed in industry would find jobs in the service trades or in the newer occupations.

Well, what this seventh chart shows is that the unemployment rate during the whole period, not just during the recessionary period, but during the whole period 1953–60, compared with the earlier period 1947–57, has gone up not in a few selected industries but almost everywhere. It has gone up in some of the very industries, including the service industries and wholesale and retail trade, where we were told that, because of the shifts in our economy, these industries were going to absorb those unemployed in the heavy industries. Charts 8 and 9 contain further analyses of employment and unemployment.

Now, we are also told that this is a problem of the displacement of men by machines, a technological problem, an automation problem. Of course, it is true that, insofar as the growth of the economy has not been sufficient to absorb both the increases in the labor force and the increases in machines, some machines have displaced some workers.

But in a more fundamental sense, if this were the explanation, we would have had idle manpower; we would not have idle machines. The machines would merely have displaced the workers and, to that degree, we would have had unemployment.

But in fact, we have also had large increases in idle machines, idle plant, idle technology. In fact, there has been a substantial correlation between the increasing idleness of our inanimate resources and the increasing idleness of our human resources. This is shown by the 10th chart, indicating for the whole period 1954–60, and again not just the recessionary periods, that the idleness of capacity in our basic industries ranged, to state it in quick summary, between 15 and 30 percent of plant capacity.

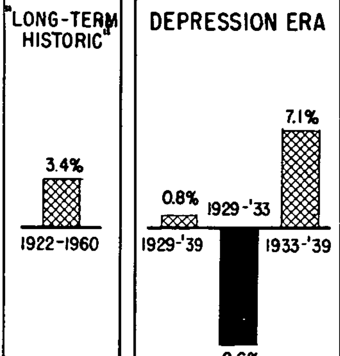
Now, to ask this question is to answer it: Can we afford as a Nation, not only in view of our domestic needs, but also the worldwide challenge, to live through 6 years when our plant capacity has run between 15 and 30 percent idle, and when in the overall, to take a rough figure, I might say that our whole economy has been nonfunctioning to the tune of between 10 and 15 percent? Chart 11 is highly relevant here.

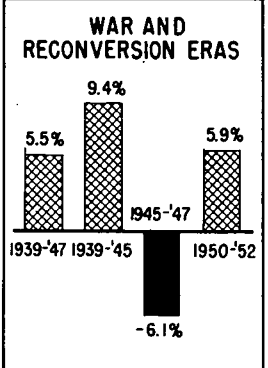
These trends have also had a very adverse effect which productivity, as shown by chart 12.

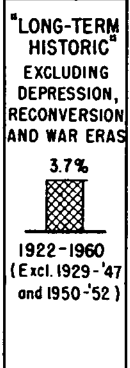
CHART 1

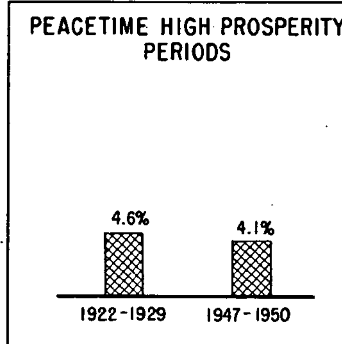
GROWTH RATES, U.S. ECONOMY, 1922-1960

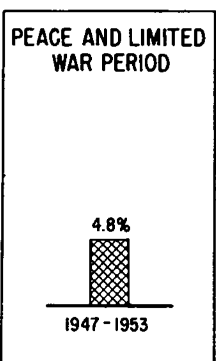
Average Annual Rates of Change in Gross National Product
In 1959 Dollars











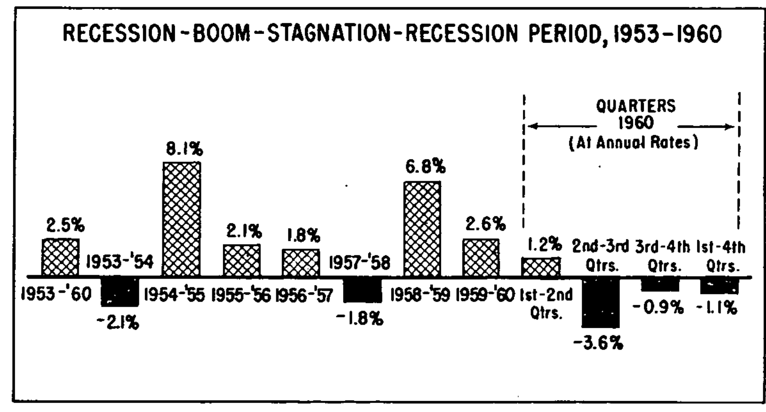


CHART 2

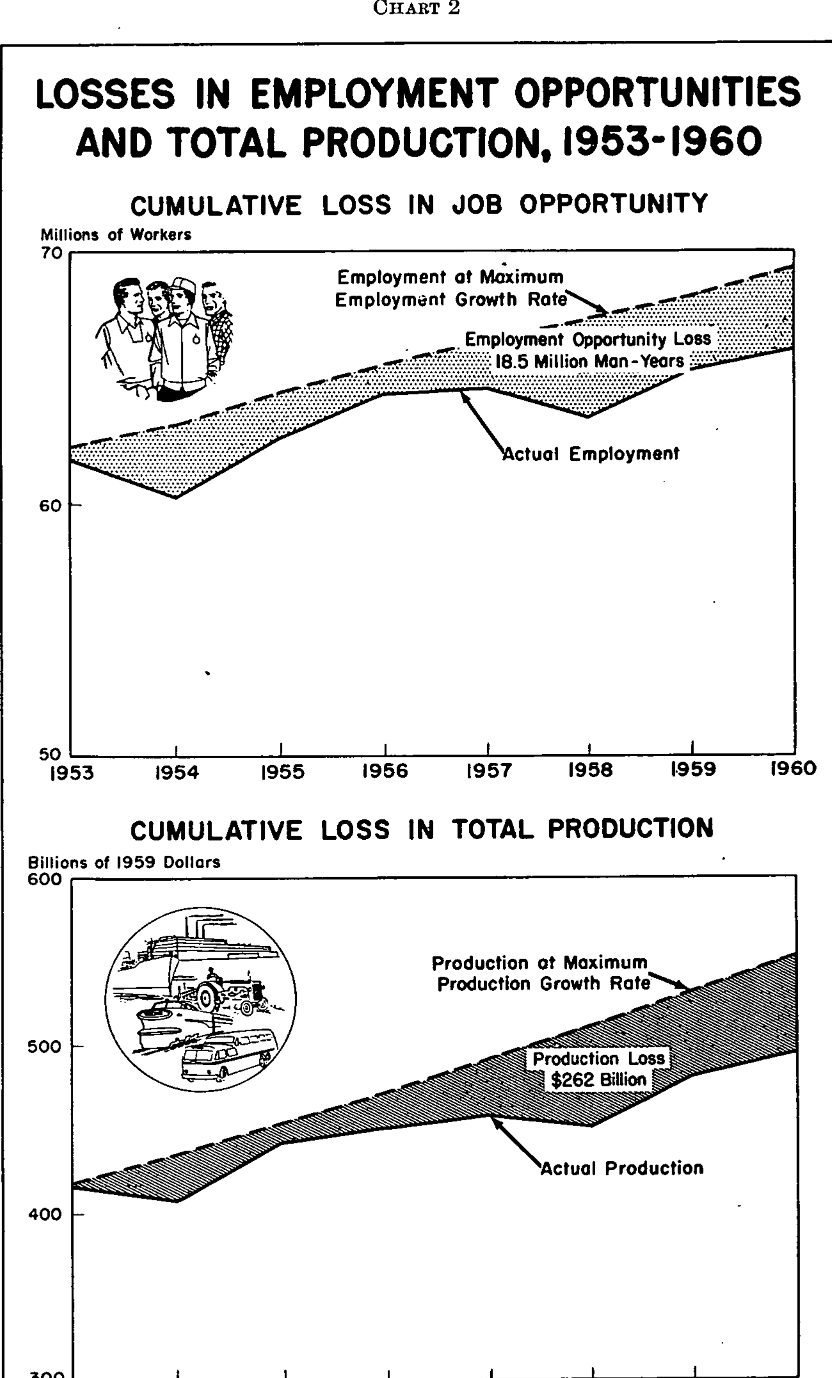


CHART 3

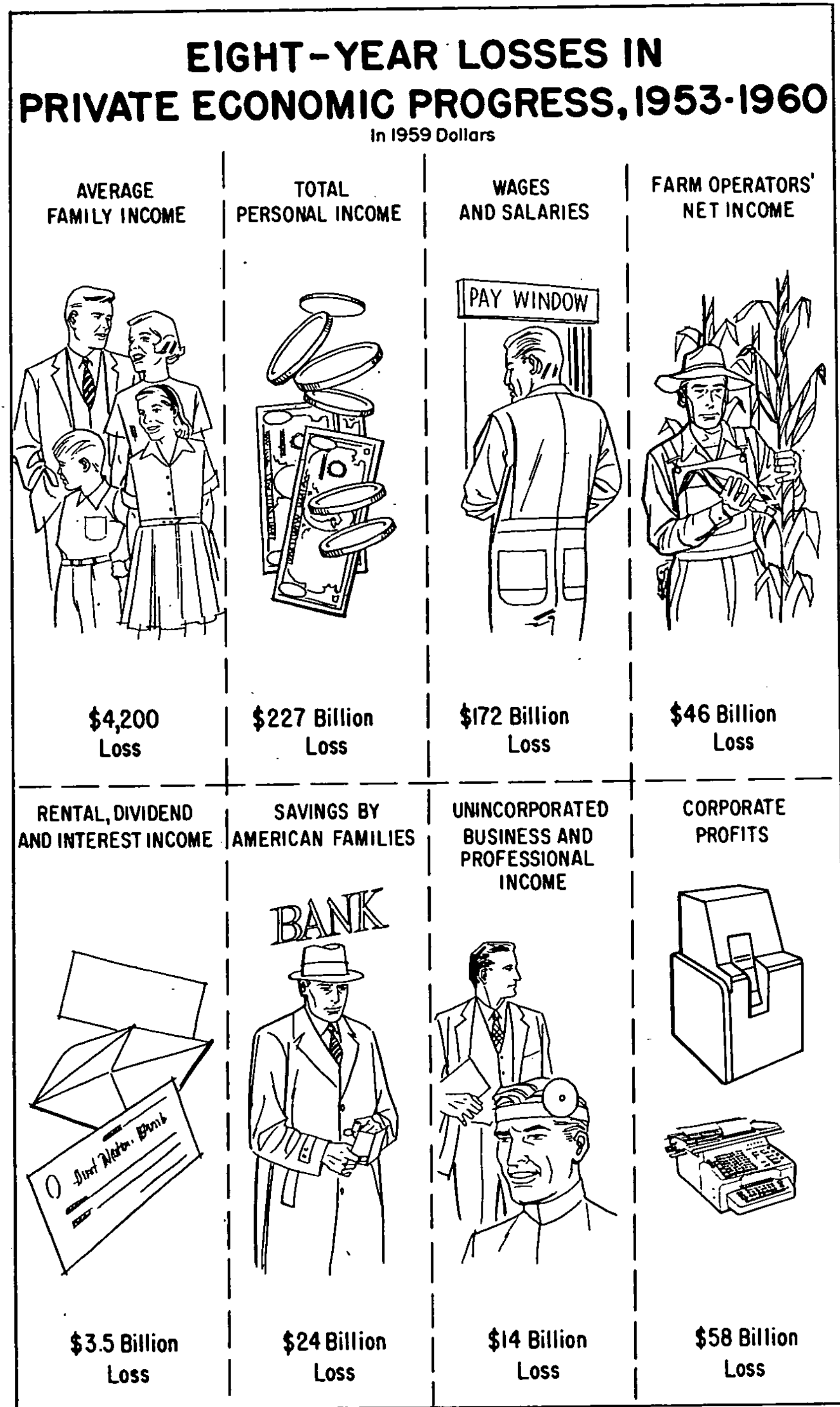


CHART 4

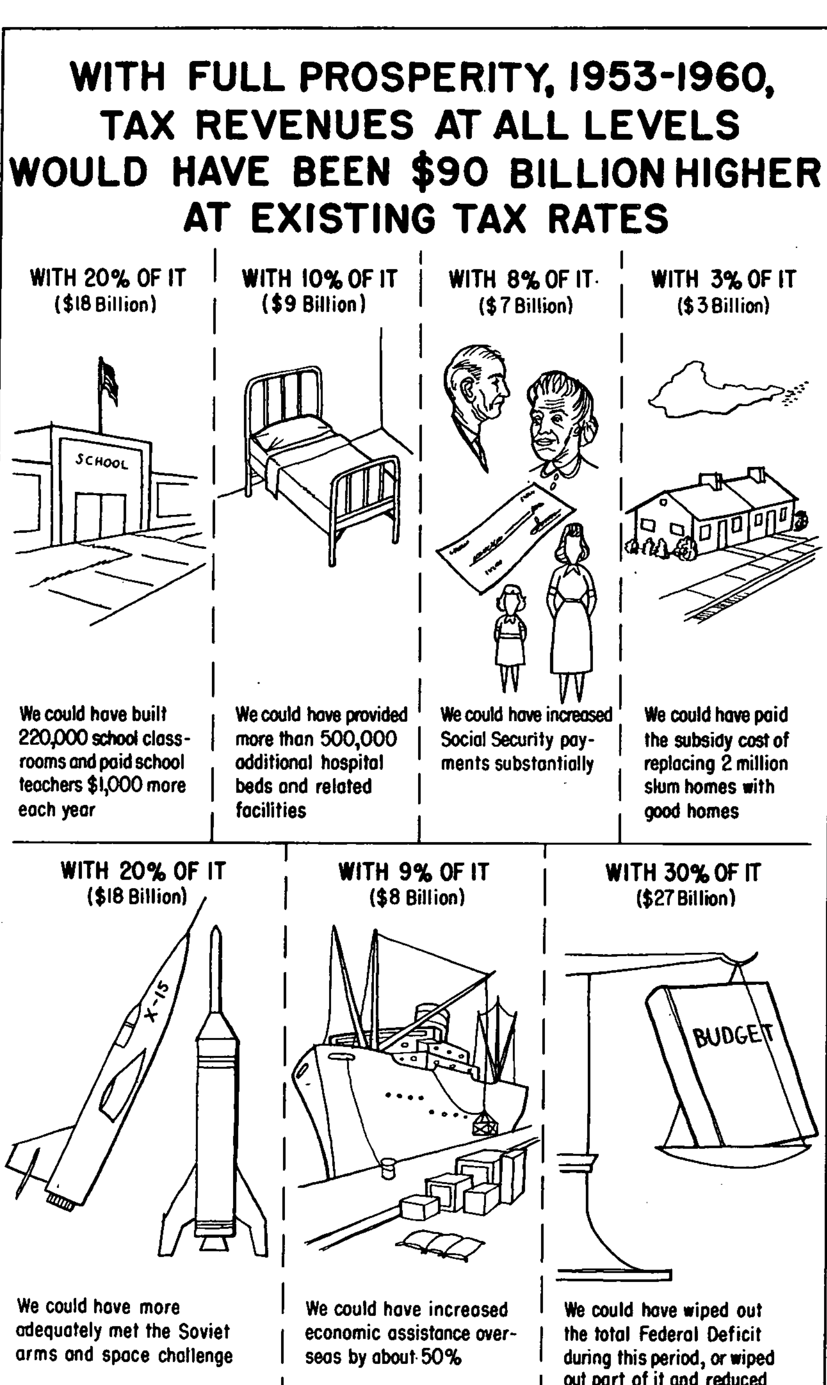
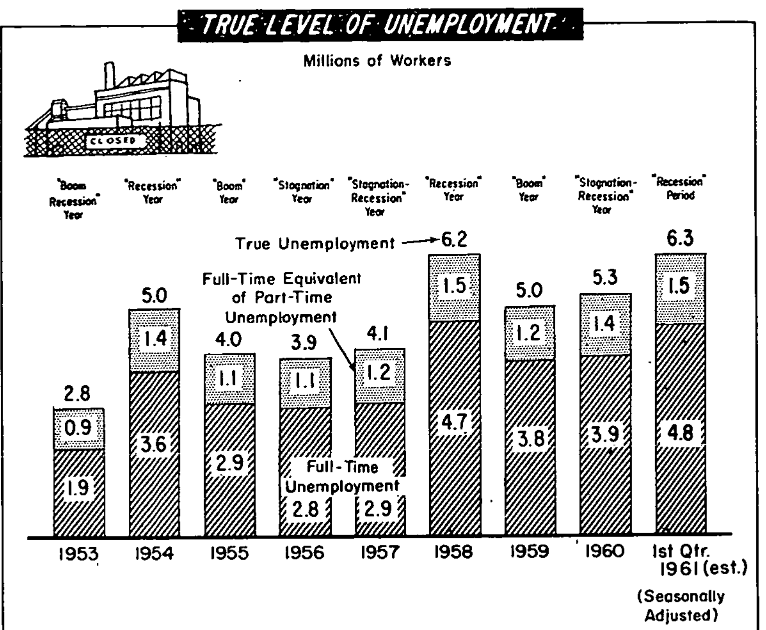


CHART 5

THE RISING TIDE OF IDLE MANPOWER



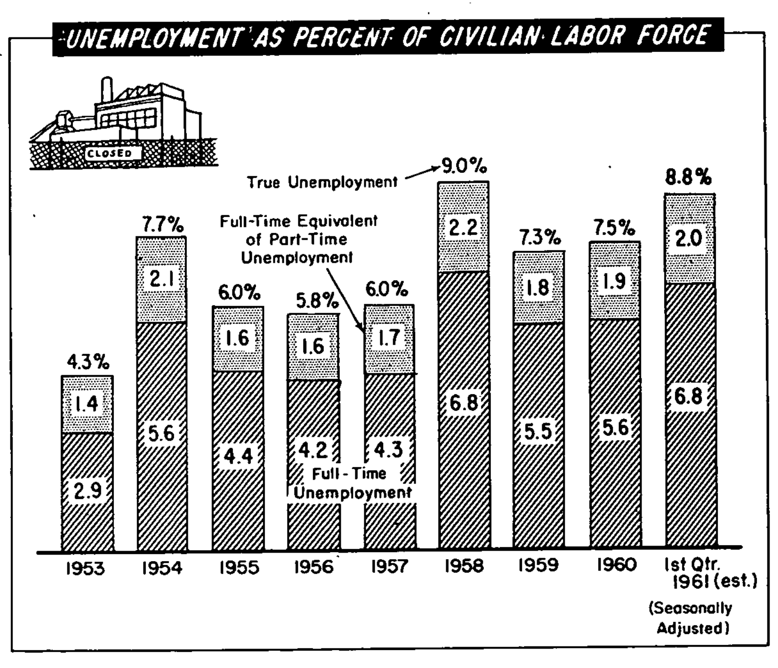
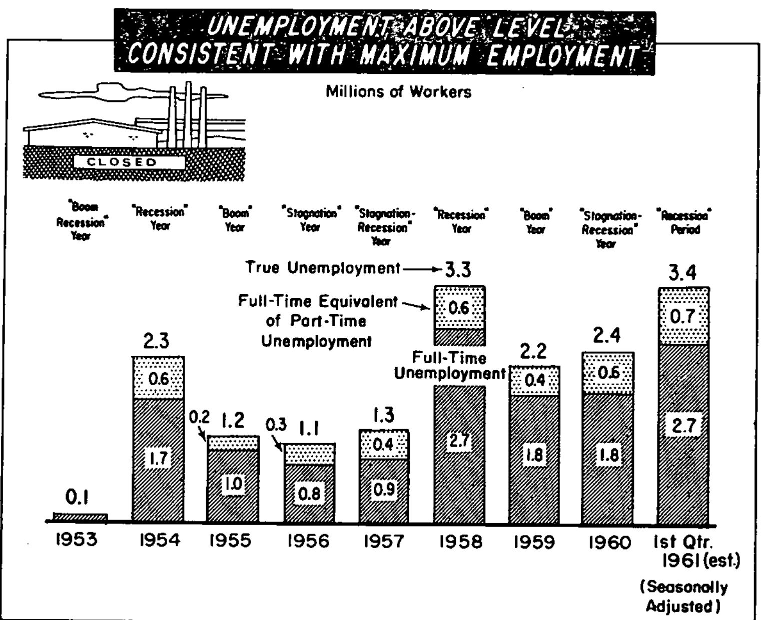
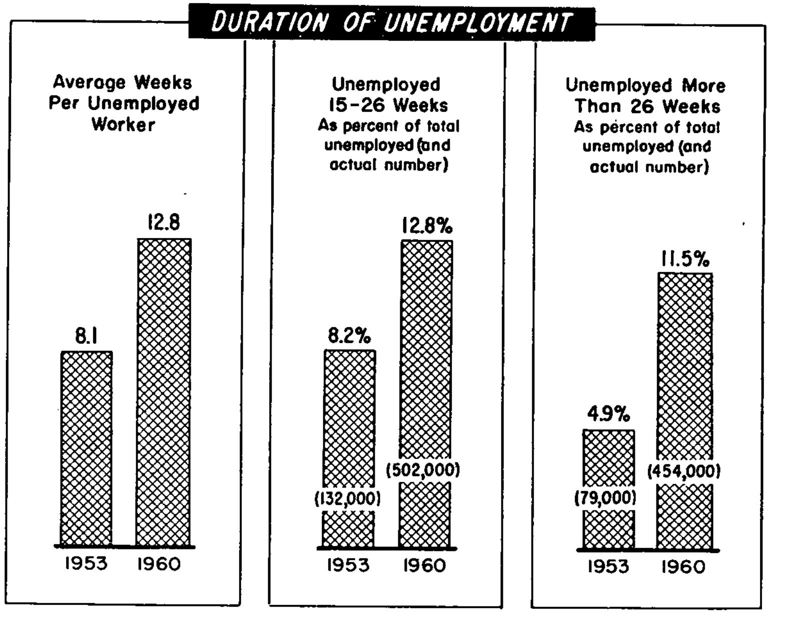


CHART 6

THE TRUE MEASURE OF UNEMPLOYMENT

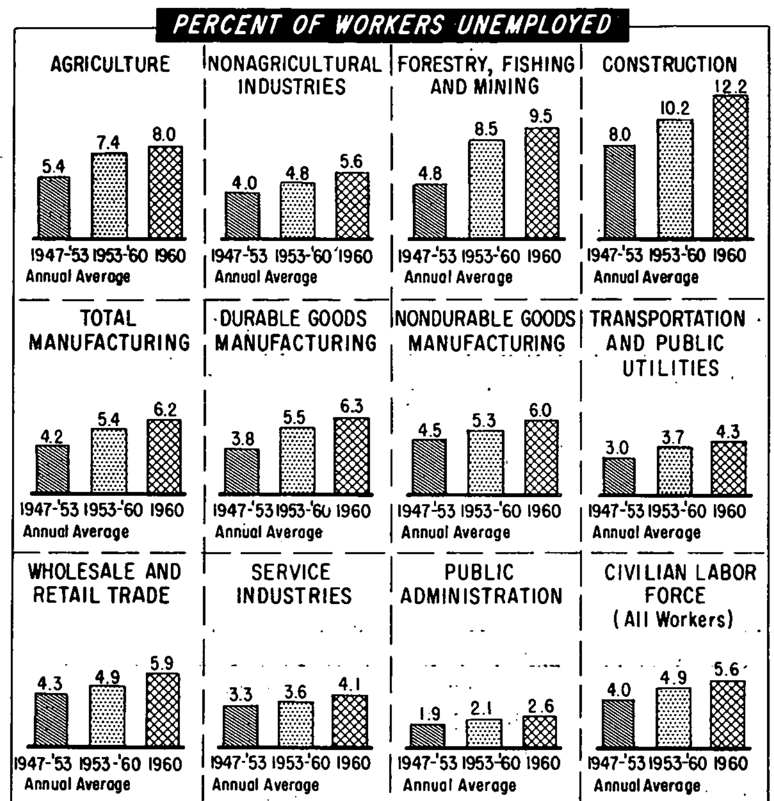


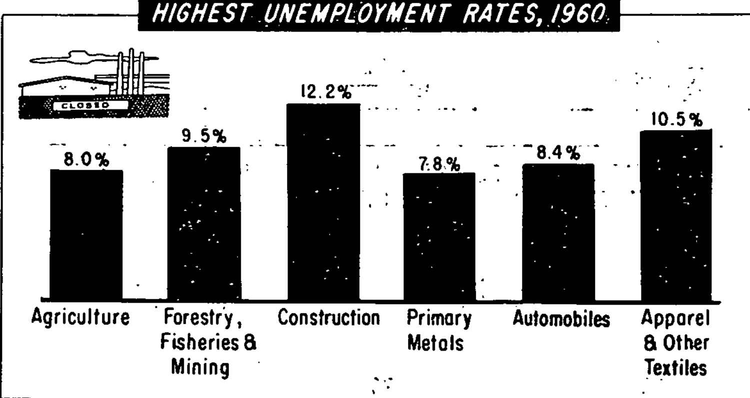


1/ The level of unemployment consistent with maximum employment is herein regarded as 2.9 percent of the civilian labor force for full-time unemployment, and 4.1 percent for true unemployment.

CHART 7

UNEMPLOYMENT RATE TRENDS WAGE AND SALARY WORKERS, 1947–1960[1]





[1] These figures cover only full-time unemployment. 1957–1960 figures are based on revised definition of unemployment and hence are not exactly comparable with earlier data.

CHART 8

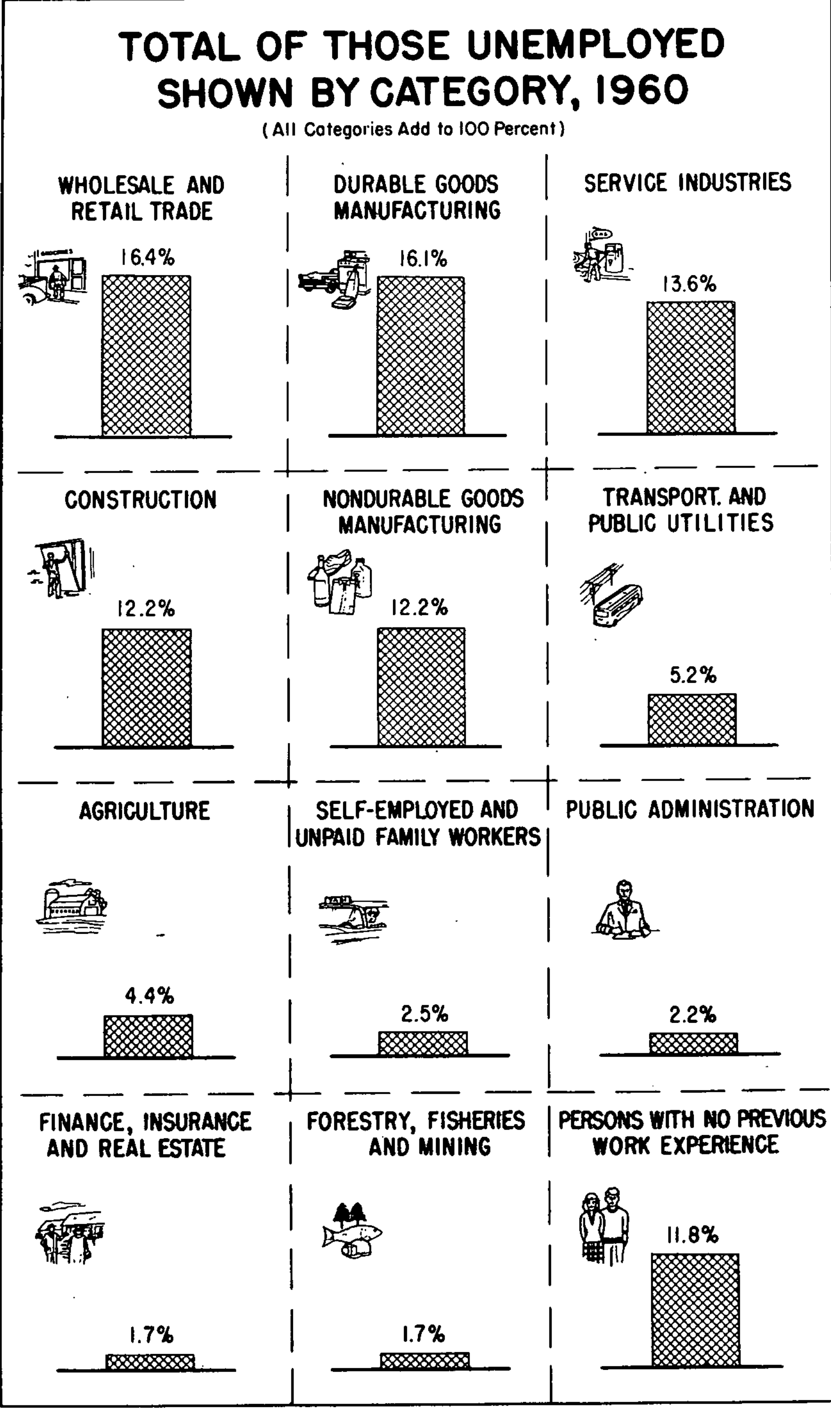
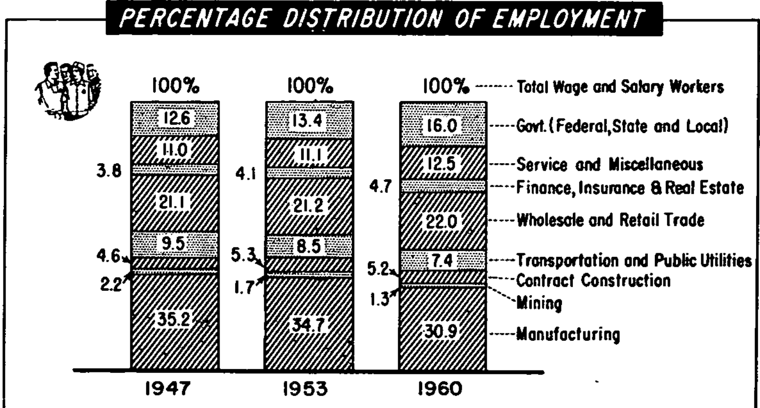


CHART 9

NONAGRICULTURAL EMPLOYMENT TRENDS -WAGE AND SALARY WORKERS, 1947-1960



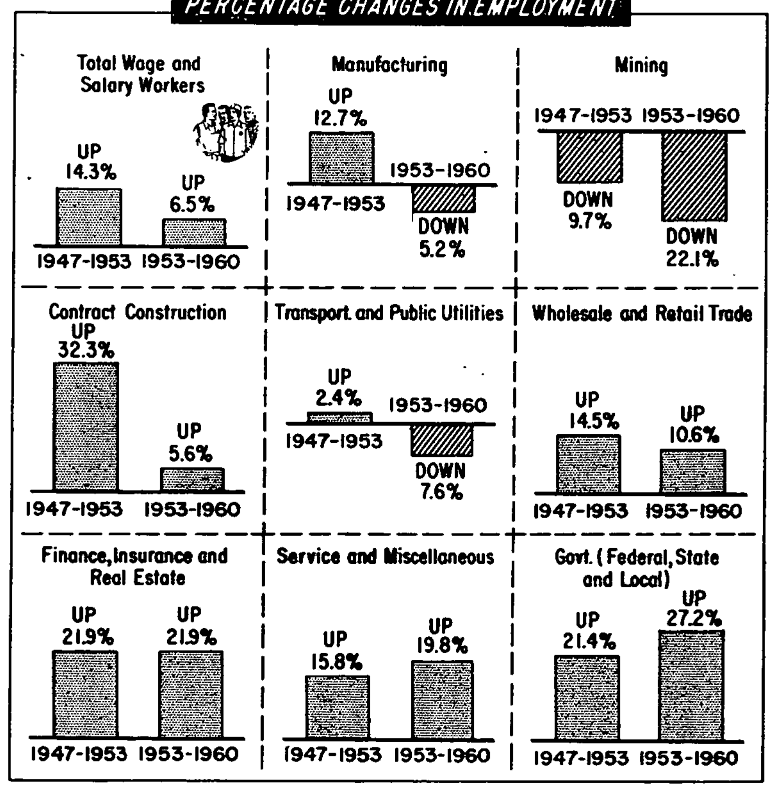


CHART 10

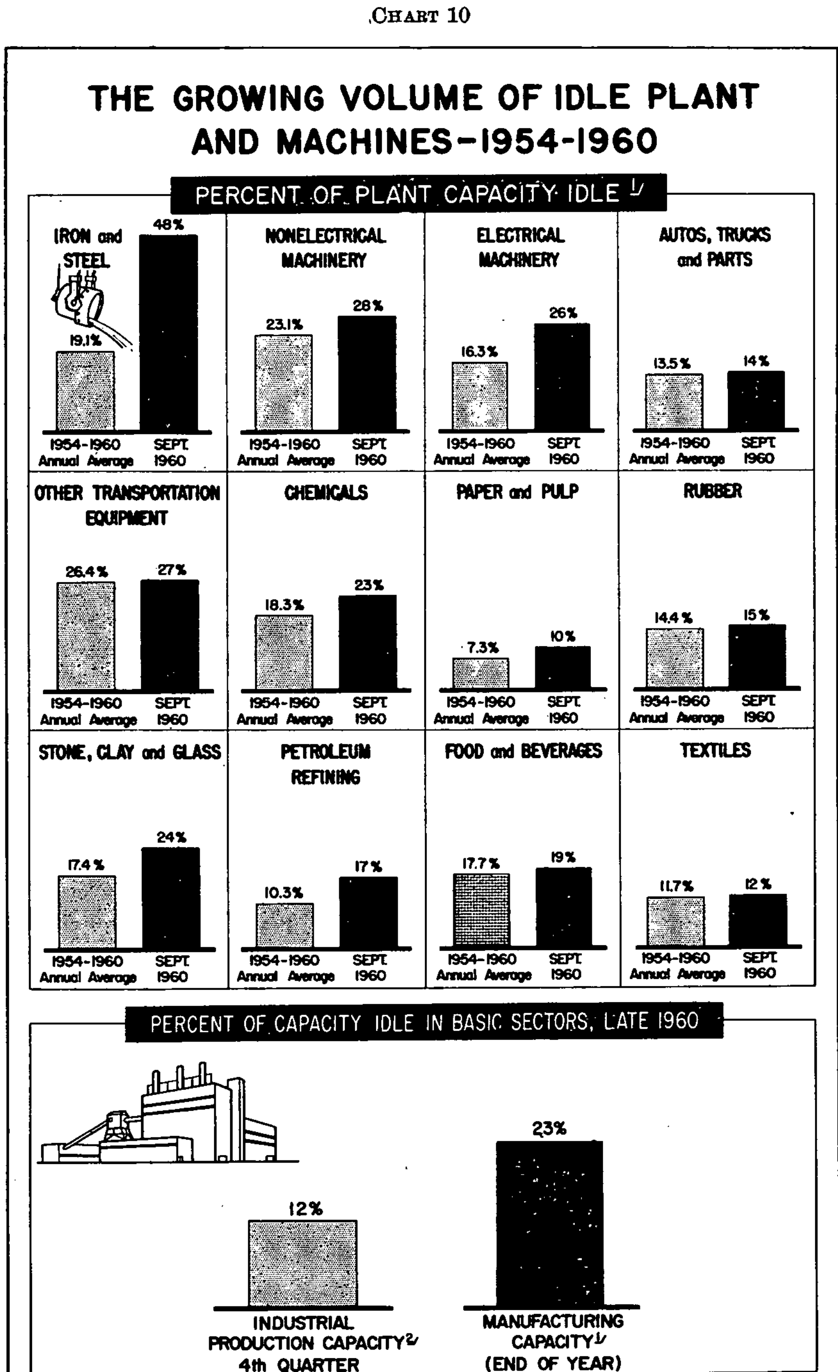
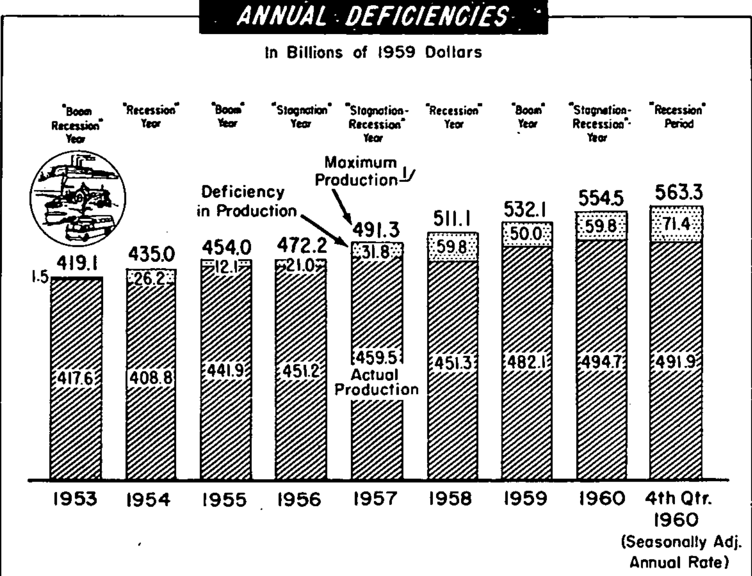
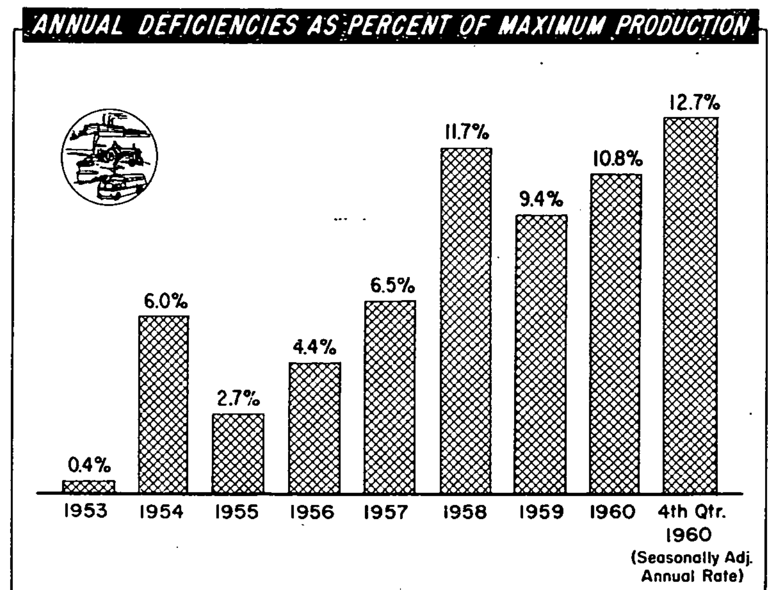


CHART 11

DEFICIENCIES IN TOTAL NATIONAL PRODUCTION (GNP), 1953-1960





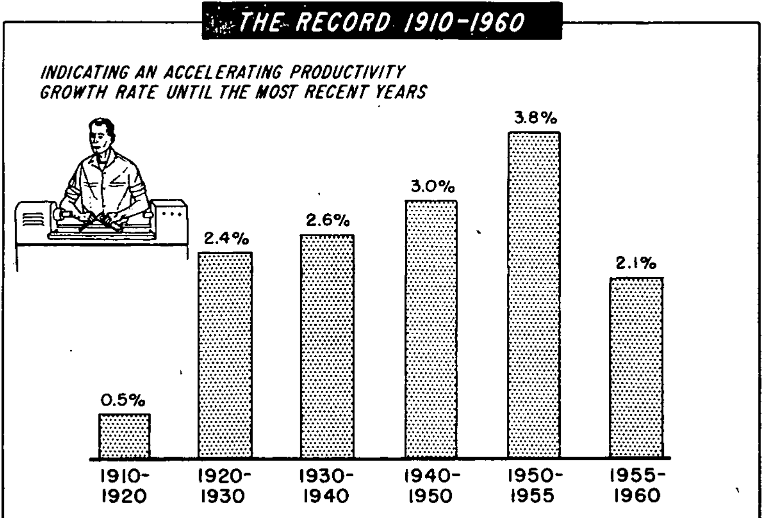
1/ Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

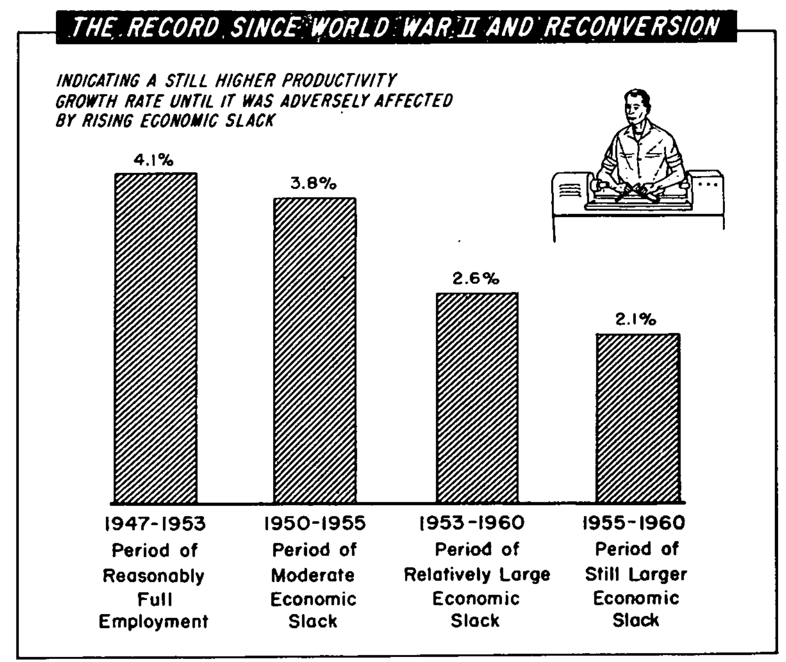
74803—61——9

CHART 12

TRENDS IN OUTPUT PER MAN-HOUR -OR PRODUCTIVITY-1910-1960

Average Annual Rate of Productivity Growth for the Entire Private Economy





Note: Based on U.S. Department of Labor estimates, relating to man-hours worked.

Now, let us move on to the matter of why all this seems to me to have happened, and then into the question of what monetary policy has had to do with this.

Basically, in my view, the American economy has become characterized by a long-term retreat from the reasonably full use of its productive resources because our technology and know-how, productivity and labor force and labor skills, and even plant and facilities in being, have been outrunning their use or distribution through the combined demand of private consumers and public purchasers of ultimate products. This does not mean that we should not and could not have had an even higher and more steady rate of growth in these productive resources; we should have and could have, if the ultimate demand upon these resources had been nearly sufficient to call forth their use and their growth in reasonably full measure. There can be absolutely no other primary explanation of severely rising idleness of plant and manpower in the long run than the inability of buyers of ultimate products to buy the products which our current state of industrial development can produce. It is unfortunate that almost all economists recognize this when they look backward to the distant past, such as the Great Depression; but somehow they do not muster the fortitude to recognize this when they are dealing with situations closer to home in point of time. It will not do us much good to recognize in 1980 what the trouble was in 1961.

It is really not so hard to recognize why and how and when our utilization of ultimate products has tended to fall so far behind our capacity to produce them. The heart of the matter is to be found in conscientious analysis of the flow and distribution of national income to and from the various sectors of the economy, as these flows bear upon what economists call a balanced equilibrium between increases in the means of production and increases in the ability to use the product.

When we look carefully at each of the short-lived booms since early 1953 which contained within themselves the seed of their own destruction, we find that investment in the basic means of production, fed by high prices and other incentives, advanced very much more rapidly than the income flowing to private consumers which underlies both their ability and propensity to spend and the public outlays for ultimate products which depend upon decisions of national policy.

If we look at chart 13,[2] what I have done is to relate trends in gross private domestic investment to trends in the combination of private expenditures for ultimate products and public expenditures for ultimate products. What we see very clearly here, taking the bottom half of the chart, is that in the period 1954–56 investment in the means of production grew several times as fast as private and public consumption combined. These particular figures happen to deal with gross private domestic investment, but I also have the figures dealing with investment in plant and equipment. And during this period, investment in plant and equipment grew more than eight times as fast as ultimate consumption both private and public.

Looking at the period 1958–60, we again see this enormous disparity between the growth of investment in the means of production and the growth of the ability to take the product. These inbalances or distortions were, of course, followed by very sharp cutbacks in business

[2] Charts 13–16 appear at 128–131.

investment and slippages in profits when they had run their course, because you do not go on making the same mistakes forever. And these sharp cutbacks, combined with the more enduring deficiencies in consumption and in public outlays, brought on the recessionary period.

Now, this is not really a very controversial argument. I am surprised at how many businessmen and conventional economists are saying now that we had a nonsustainable boom between 1956 and 1958, and in other periods, and the term "nonsustainable" means simply that one part of two horses hitched to a team got loose from the reins and was running far ahead of the other, and then had to sit down because the other could not catch up in any other way.

This is rather standard economic analysis.

It should be noted also that high and rising prices and profits supported these inordinate investment booms, as shown by chart 14.

Now, what did the money policy have to do with this? And I want to say something about housing in a minute, because I recognize the interest of members of the committee in it, and it is tremendously important.

Conventional economics and conventional monetary policy have had a very simple formula, much simpler than the truth. The formula has been that, if you are faced with recession or depression, you expand the money supply. If you are faced with inflation, you contract the money supply.

Within limits this has merit, but it does not get to the real heart of the problem of how we have gotten into these economic difficulties. Theoretically, if we had a system of perfect competition, expanding the money supply would mean higher prices and reducing the money supply would mean lower prices. But we would have full employment all the time, nonetheless, just different dollar values.

By way of analogy, if you sit at a poker game and you double the number of chips but reduce the price of each chip in half, it is the same. The poker game becomes different when you rearrange the chips, or have some hand sweeping across the table and giving some chips from one pile to another in an irrational way.

The central problem in our economy, with which monetary supply as well as other national economic policies should deal, are these matters of relationships, these matters of a sustainable balance between investment and consumption, which are fundamental. So are matters of distribution of income within the personal income stream because, if you get a bad distribution of personal income, the people at the top are looking for more and more sources of investment and/or speculation; the people at the middle and the bottom have a propensity—I do not like the word "propensity," they really have a human need—to spend a larger part of their incomes.

Thus, if the income is redirected away from them, you tend to get a shrinkage of consumption relative to investment and speculation for the reasons that I have given.

This is why the so-called irrationality of the stock market seeming to rise at times when the economy was about ready to go down is not an irrationality at all.

Chart 15 shows my estimates of the deficiencies in consumption 1953–60, and chart 16 shows estimated deficiencies in the main components of GNP.

It might have been expected that a record so deficient and challenging would have prompted the Commission on Money and Credit, highly staffed and with great financial resources, to probe deeply and analytically into the causes of all this. Economics not being an exact science, this would not have produced conclusions with which all would agree. But it would have produced conclusions which would have added mightily to the concrete foundations for further efforts in the same direction. But one can go through the report of the Commission with a fine-tooth comb and gather almost none of this kind of analysis, and almost none of these kinds of conclusions. And many of the conclusions which are stated or vaguely implied run so counter to what I believe this kind of analysis would reveal, that I believe the acceptance of these conclusions by those charged with the responsibility of public economic policy would be quite damaging.

Some or many parts of my analysis may be wrong, but this does not operate against the necessity of such an analysis, and I challenge those whose analysis may seem to have more merit to come forward with it so that the policymaker may more effectively exercise his judgment and make his decisions. In short, my prime objection to the report of the Commission is not that it offers an analysis which differs from mine, but rather that its attempts at analysis are so shallow and secondary that they pretend to deal with problems which they do not really touch.

In developing this theme, I do not exaggerate the influence of monetary policy in contradistinction to other public and private economic policies. There were other mistakes of policy which did plenty of damages, and perhaps the perponderance of the damage. But my responsibility here is to concentrate upon monetary policy.

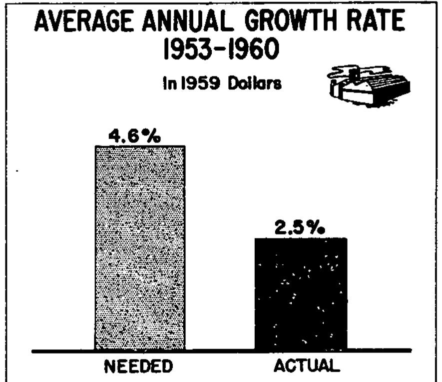
First, the money managers did not even pretend to give priority to economic growth, to the reasonably full use of our resources, nor to meeting the priorities of our national needs. Despite some inconsistencies in their statements, their main claim was that they were seeking to stabilize the price level and to defend the value of the dollar. These are estimable objectives. But when pursued in isolation, they are not only far too narrow but also self-defeating, as evidenced by the fact that the period 1955–60 combined an unusually low rate of economic growth with an unusually high amount of price inflation for a period other than wartime when the causes of inflation were entirely different from what they have been in recent years.

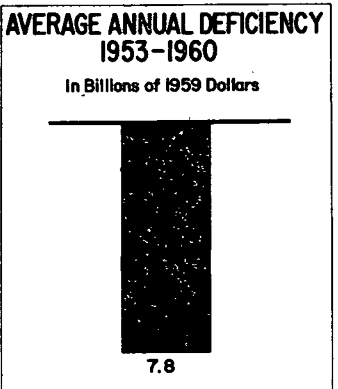
Now, I recognize, and those of you on the committee know better than I, that the money managers have seemed to take many conflicting positions. But their basic theme—in any event, the core of their action—has been that "it has been our job to stabilize prices, to stabilize the economy," rather than to deal with these other priorities of national need. Despite some inconsistencies in their statements, their main claim has been that they were seeking to stabilize the price level and to defend the value of the dollar.

These are estimable objectives. But when pursued in isolation, they are not only far too narrow, but also self-defeating, as evidenced by the fact that the period 1955–60 combined an unusually low rate of economic growth with an unusually high amount of price inflation for a period other than wartime (when the causes of inflation were entirely different from what they have been in recent years).

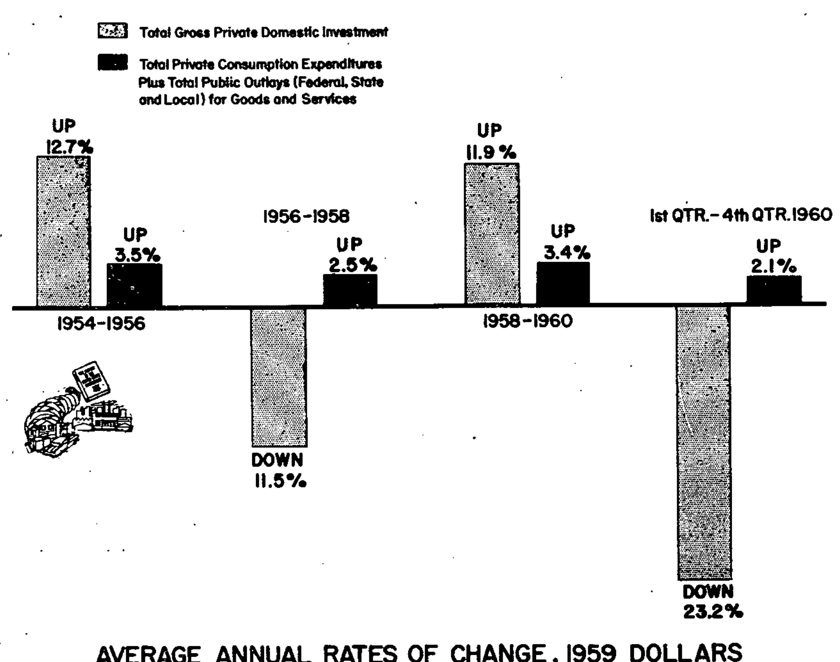
CHART 13

GROSS PRIVATE DOMESTIC INVESTMENT WAS DEFICIENT DURING 1953-'60 AS A WHOLE





BUT AT TIMES INVESTMENT FAR OUTRAN CONSUMPTION; THIS LED TO RECESSIONS AND CORRECTIVE INVESTMENT SHRINKAGE



AVERAGE ANNUAL RATES OF CHANGE, 1959 DOLLARS

CHART 14

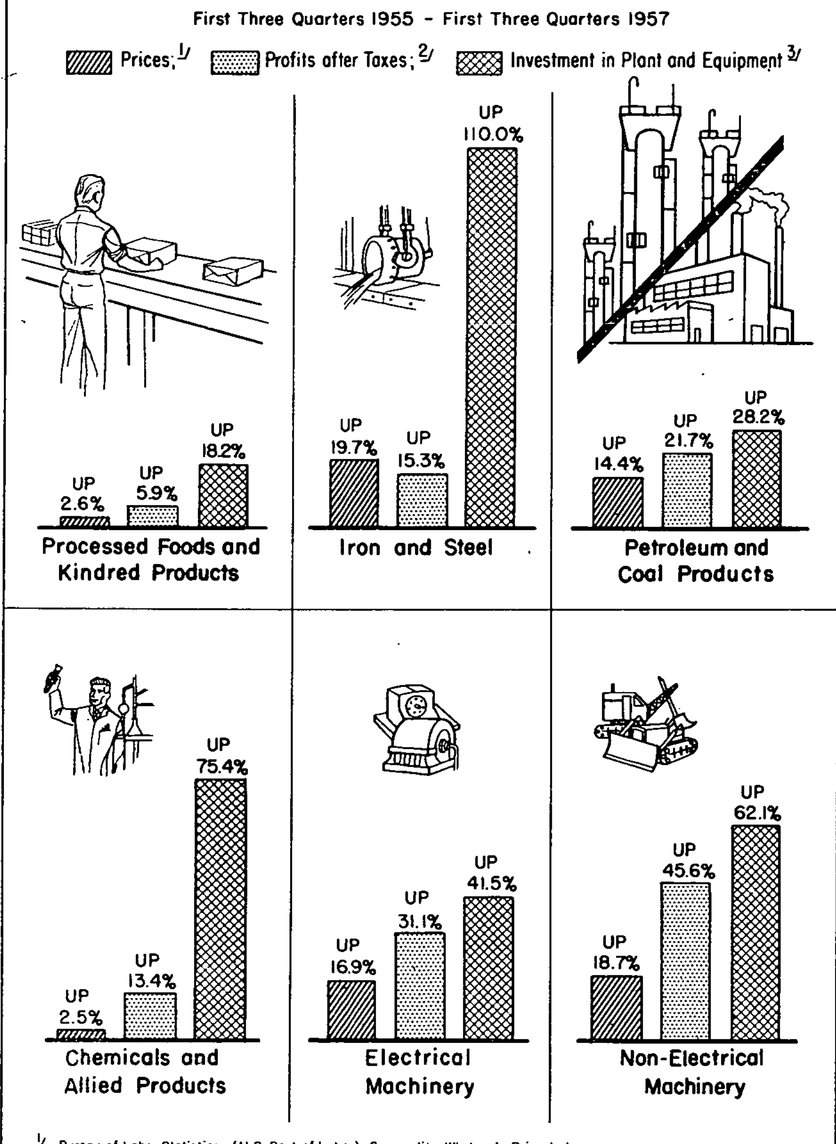
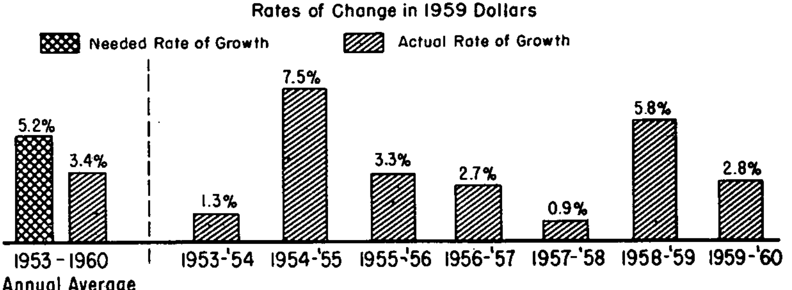
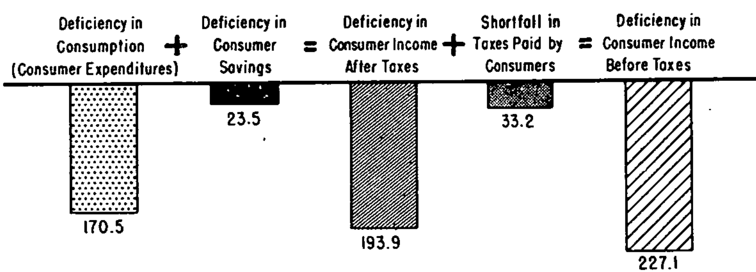


CHART 15





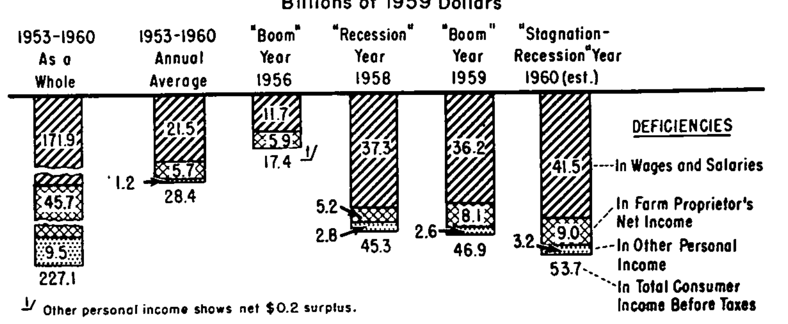
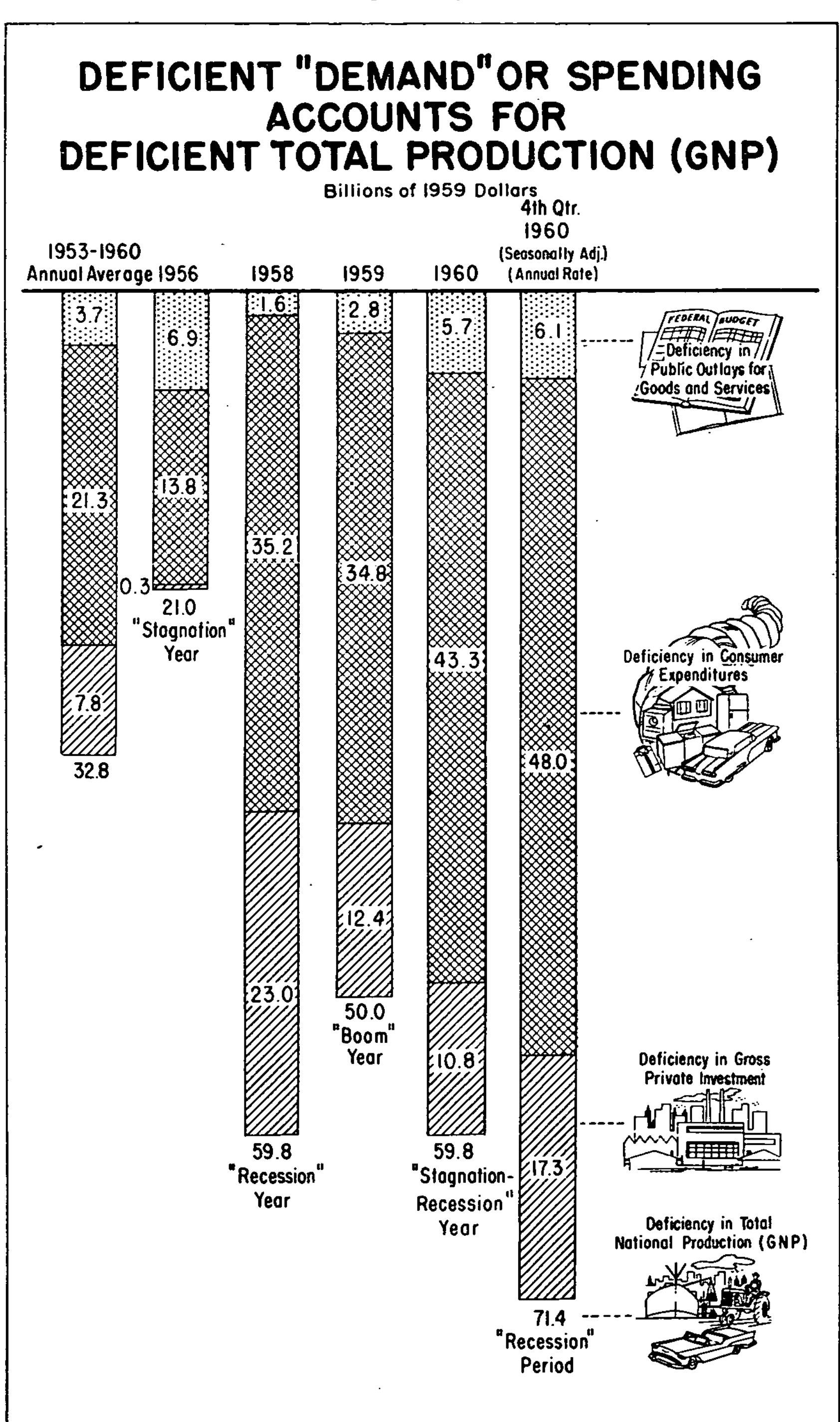


CHART 16



I have on other occasions presented the whole matter of the causes of inflation, and have come up with the conclusion that the fact that we had inflation during wartime, when all of our resources were overstrained, has been persistently used since as an argument for the proposition that even a slack economy should be made even slacker in order to avoid inflation, not recognizing that, just as the inefficiencies of excessively high use of our resources produce inflation, similarly, short of a great depression, particularly in an administered price system, the efficiencies of an excessively low use of our resources produce inflation, and this is documented by experience.

Second, through their astigmatic views, the money managers held the growth of the money supply to levels tremendously below those required for an adequate economic performance. During the period 1922–60, as a whole, as shown on the top two parts of the chart, a 5.4 percent average annual increase in the money supply floated an average annual increase of 3.4 percent in the real value of the total national product. The real value, not the price inflated value.

During the period 1953–60, the average annual increase in the money supply was held to the tragically and ridiculously low figure of 1.3 percent, and the average annual growth of the economy in real terms was only 2.5 percent. And to cap the climax, during the period 1955–60, the average annual increase in the money supply was held to 0.8 percent, which I could not believe if it had not happened, and the average annual growth rate in the real economy was only 2.3 percent.

Chart 17 [3] shows this; the bottom part of it also shows the inverse correlation between the rate of economic growth and the amount of price inflation. In other words, we had an increasing crescendo of price inflation as the growth rate was reduced and as the annual growth of the money supply was reduced.

To repeat a rather inelegant example I once gave, the fact that you have too little water in the well does not prevent the pigs who can get there first from drinking more of it than they should, and this is the kind of price inflation we have had in recent years.

Third, the restraints in credit availability resulting from the incontinent restraints on the money supply, and the interest rate increases attendant upon these policies, seriously shifted the flow of both credit and income in perverse directions, therefore seriously shifting the use of our economic resources in nonsustainable directions, and thus contributed to the basic economic distortions which I have already described. The so-called tight money policy had very little effect upon the relatively excessively investment booms, because the pacemakers in these booms were very little dependent upon credit or interest rates in view of their high degree of financing through internal sources and their capacity to finance through the price system itself. But business and farm entrepreneurs of smaller size were seriously hurt. And so were private consumers. And so were public outlays, especially at the State and local levels, but also to a degree at the Federal level, because of tighter credit and higher iterest rates.

I want to say a word about housing now. If the Commission on Money and Credit had made the kind of quantitative analysis of the economy in action to which I am referring, had asked this question:

[3] Charts 17 and 18 appear at pp. 134 and 135

At what points could different lines of development within the economy have produced better results, which is the essence of really mature economic analysis of an economy, as of anything else, they would have reached, I submit, this conclusion:

That regardless of periods of upturn and downturn, the net average annual development of residential construction has been grossly below a fairly budgeted estimate of our balanced economic requirements, not only from the human point of view, but also from the economic point of view.

And this has been compounded during the so-called boom periods, when the tight money policy operated against housing but did not operate against the key investors. If, during these periods, we had had more flowing into housing and less flowing into these exorbitant investment booms, we would have had a better balance throughout because housing is both investment and consumption; we would have had a more sustainable level of business investment; and we would have been better off all around.

This is infinitely more true as applied to the future, because I am convinced, as I will show in a minute, that with the new technology and automation, there is nothing so promising as housing and urban renewal, to which we can turn in a large way to take up the technological displacement in some of the other industries which will occur even if we have a very high rate of economic growth, and I will say more about this later on.

This is not wandering from the subject of monetary policy, because we see the money managers and the students of money policy saying in effect: "After all, this problem of distribution within the structure is not very important; we will just look at the whole picture; we do not care too much about how it works in detail"—well, these are not "details" or these are the kinds of details which really describe how the economy is working and where the problems are occurring.

Comparing 1960 with 1952, as shown by chart 18, interest rates on long-term Treasury bonds rose 50 percent, as shown by the lower part of this next chart; and on shorter term issues, rose much more, up to 96.1 percent in the case of new 9- to 12-month Treasury issues. I have estimated that average interest rates on all public and private debts rose 36.2 percent.

The other figures are not my estimates. They are the official figures. But there is no official estimate of what the average interest rate increase in the overall has been. And one of the things that surprises me very much is that the money managers, who are effecting these interest rates, have never cared enough about their consequences even to get the kind of basic data which a student of this subject would want to use if he were trying to make an analysis. So I have had to do independent economic research, with two or three people, on a job which agencies with hundreds of people and millions of dollars have not done because they have not thought it important.

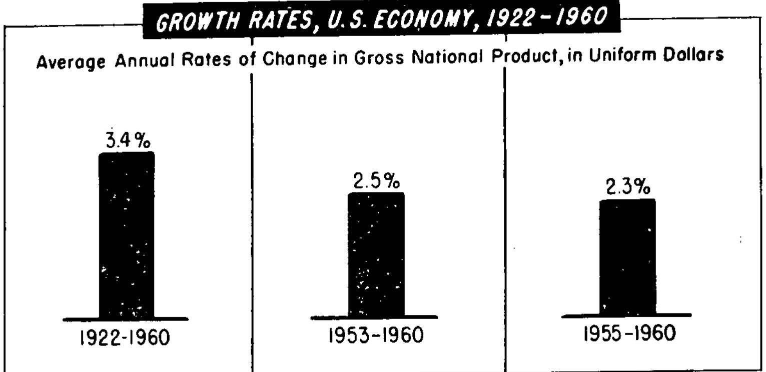
I have estimated—and this brings me to the 19th chart [4]—that the interest costs, in excess of those which would have developed if the 1952 level of interest rates had been maintained, aggregated $32.5 billion during the period 1952–60 as a whole.

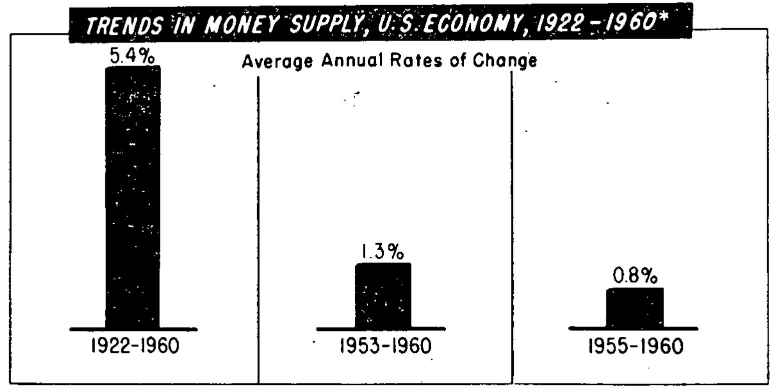
I cannot see where this type of reconstruction of the flows of national income did any good, and I can see where it did a great deal of harm.

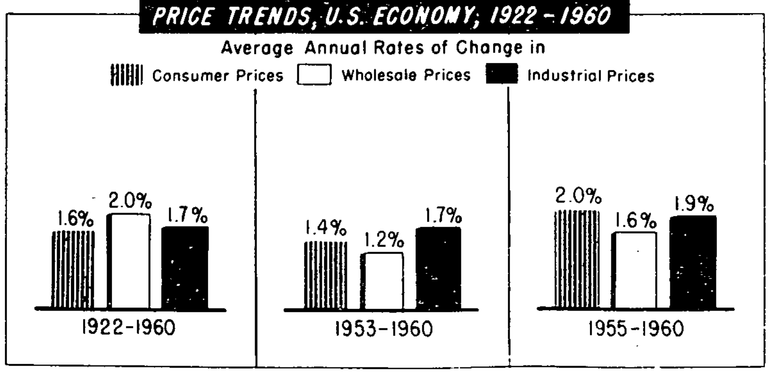
[4] Chart 19 appears at p. 138.

CHART 17

LOW GROWTH AND HIGH INFLATION HAVE CHARACTERIZED RECENT YEARS



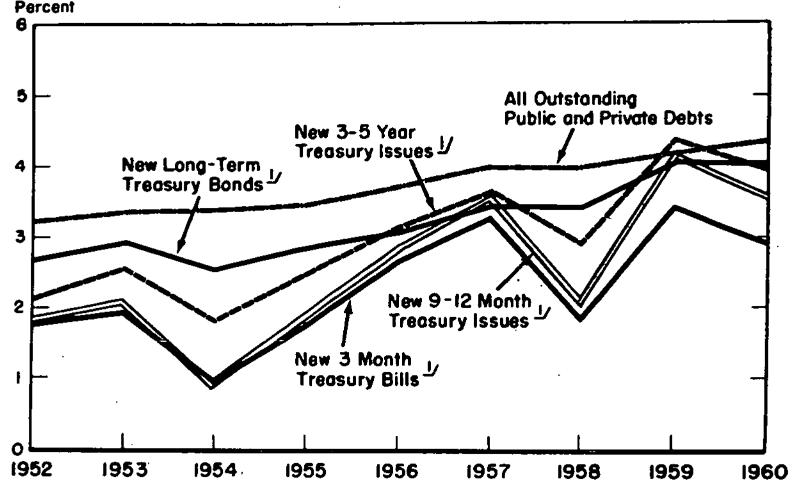




*Non-Federally held money supply, including demand deposits adjusted and currency outside banks as of June 30 or nearest available date.

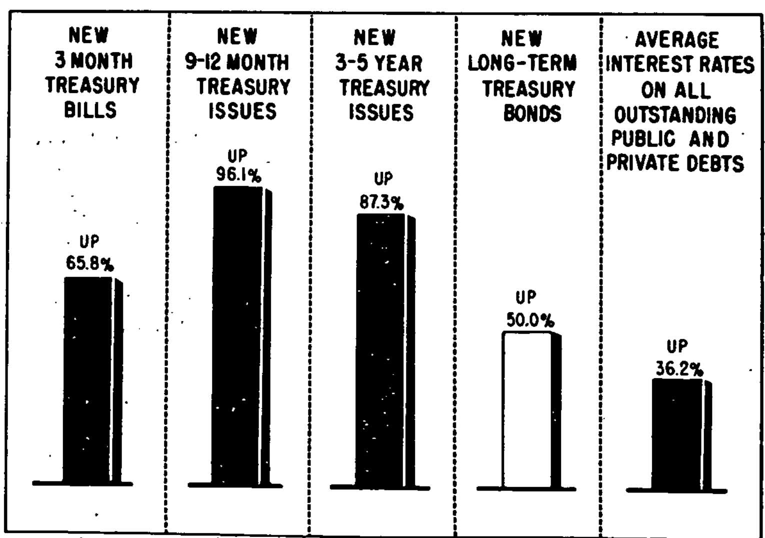
CHART 18

INTEREST RATES, TREASURY NEW ISSUES; AVERAGE INTEREST RATES ON PUBLIC AND PRIVATE DEBTS OUTSTANDING; 1952-'60



PERCENT RISE IN INTEREST RATES 1952-1960

Calendar Years



1/ Current Rates

Now, let me say something on this, because I will be challenged on it, not because I am wrong, and not necessarily by this committee, but because it is such an important point. Those who question this point will come in and say: "Well, you talk about these higher interest rates causing an excess flow of $32.5 billion, which otherwise would not have flowed from the borrower to the lender if the interest rates had not gone up."

They will also say: "That is a misleading figure. Some borrowers are lenders; some lenders are borrowers; some of the people may have paid more interest on one side and gotten more interest on the other side."

And then they will say: "The whole thing becomes so complex, when you try to analyze it, that you do not know what it means."

This is not the point I am making. I am not talking here so much about the redistribution of income—although I will say something about that—but rather of the use of a national economic policy—and I insist that it is that—to prompt a disturbing and disequilibriating flow of interest income from one place to another.

For this purpose the $32.5 billion figure is relevant. And it is further relevant because, if you can use national economic policy to do this, for which no case can be made that I see, you could alternatively use other national economic policies in a free society and with no greater effort and with far more directness and certitude to produce a different series of churnings of national income that would have done infinitely more good. In other words, you have an election.

As chart 19 shows, there are various different results which might have been achieved through alternative flows of $32.5 billion.

Looking at every family in the United States with incomes below $2,000 a year, which is a fantastically low American standard of living, and who I estimate had incomes on the average of about $1,250—this is enough money, and I am merely trying to give an impression of its magnitude, to have doubled the incomes of all of these families for the whole period for which this is calculated.

And without going into further details, if we go higher up the income stream, if, instead of taking all the families under $2,000, we take all the families under $4,000, we would still have been able to lift their incomes very substantially.

Or, in the alternative, as shown in the center of chart 19, if we had remanipulated this amount of income flow in the interest of the priorities of our public services, we could have increased our outlays for a wide variety of very important public services without absorbing more than a tiny fraction of what has been paid out in excess interest rates.

Here the analogy is very close, because a large part of the payments in excess interest rates have been public payments by public bodies which, therefore, did not have the money to do the more necessary things within the confines of budgets of the same size.

I want to show just a few additional facts which are illustrative.

As shown by chart 20,[5] comparing 1960 with 1952, total national production in current dollars rose about 45 percent. But looking at the banks in the Federal Reserve System, their net current earnings rose 102 percent, and their earnings on loans rose 148 percent. Measured in uniform dollars, comparing 1960 with 1953, as shown by chart 21, farm proprietors' net income declined 18.2 percent; per capita disposable income rose 11.8 percent; wages and salaries rose

[5] Charts 20 and 21 appear at pp. 139 and 140.

22.4 percent; the average interest rate on total public and private debts, according to my estimates, rose 36.2 percent; and personal interest income rose 73.5 percent.

Senator DOUGLAS. Mr. Keyserling, what do you mean by "personal interest income"?

Mr. KEYSERLING. "Personal interest income" means the income received in the form of personal income in the form of interest, which are most income payments. I can lend money to a corporation; it comes to me as——

Chairman PATMAN. I believe you refer to page 2 of Economic Indicators and page 3 for the others, which includes the interest on the national debt. Is that not the difference?

Mr. KEYSERLING. Yes, sir. I am glad Senator Douglas has brought out the point, because personal interest income does not seem to embrace, as you listen to it, the income that I get if I invest money in a corporation. But if I lend money to it instead of investing, the income that I get is personal interest income.

But so far as we can tell, none of this kind of analysis was of much interest to the Commission on Money and Credit. In other words, the analysis of the rationing of resources—and I am repeating for just a minute because one of the Senators has come in—the rationing of resources which is affected by the flows of national income and which I have been describing. I mean allocation of resources through the free market, Senator, as well as through public policy. I do not mean "rationing" in the technical sense.

None of the allocations of resource use, on which depend how an economy functions both from the viewpoint of performance and equity, and as affected by these flows of income, including interest payments, have been really analyzed by a Commission which has undertaken to make recommendations with respect to monetary policy, presumably on the basis of how it has worked.

Let me pass quickly over a few illustrations of this. Instead of examining the excessive investment booms which took place, the report says that the argument that the monetary restraints had little effect on business investment "seems overstated."

I do not want to take too much time. I could go into the Commission report in more detail, and show that it moves around in a complete circle, in talking about the effects on small business. First, it says that the monetary policy did not have much effect on small business because the banks lent less to small business for other reasons, and that the other reasons were that the small businesses exerted a lower level of demand or this or that. But the level of demand of the small businesses may have been affected by the interest rates they had to pay, or affected by the general conditions of the economy as affected by the monetary policy. So this is just a completely circular effort to brush this thing off and to say that it had little effect.

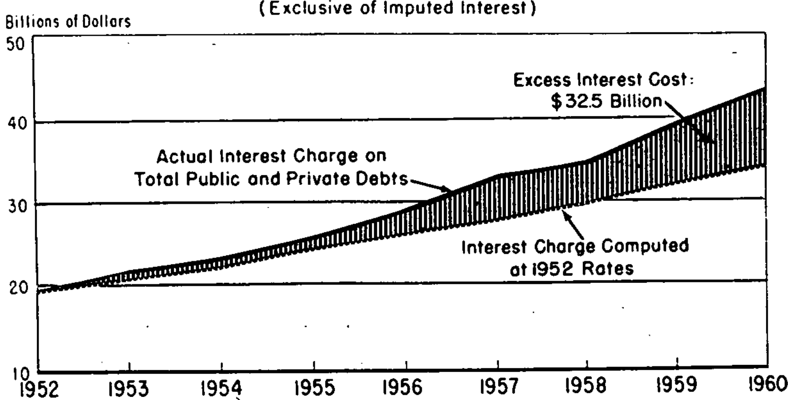
Ignoring the whole problem of the vast deficiencies in consumer incomes and spending during recent years, as measured against the full use of our resources, the report tosses this whole matter off with this bland and unsupported statement:

> The evidence indicates that changes in credit terms have some, but only a slight, direct effect on consumer expenditures for other than residential construction.

CHART 19

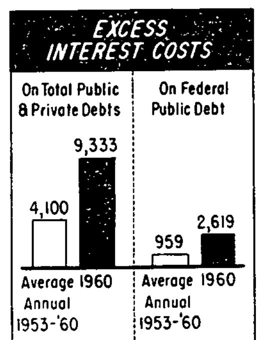
COST OF RISING INTEREST RATE ON ALL PUBLIC AND PRIVATE DEBTS, 1952-1960

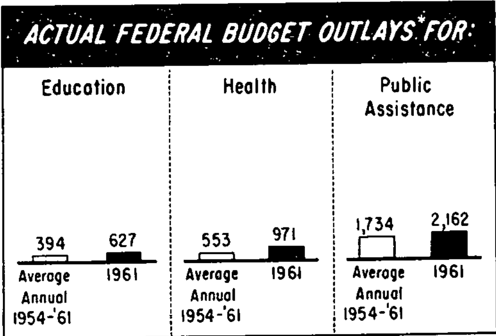
(Exclusive of Imputed Interest)



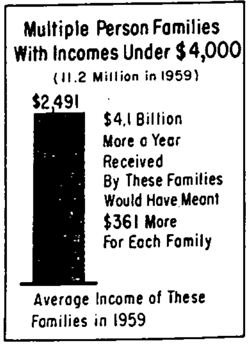
EXCESS INTEREST vs PUBLIC OUTLAYS

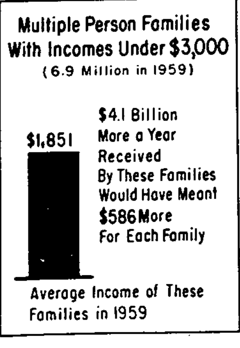
Millions of Current Dollars

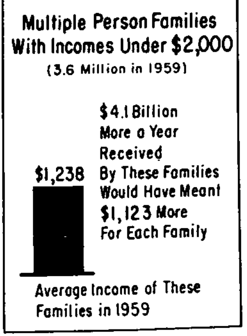




EXCESS INTEREST vs FAMILY NEEDS





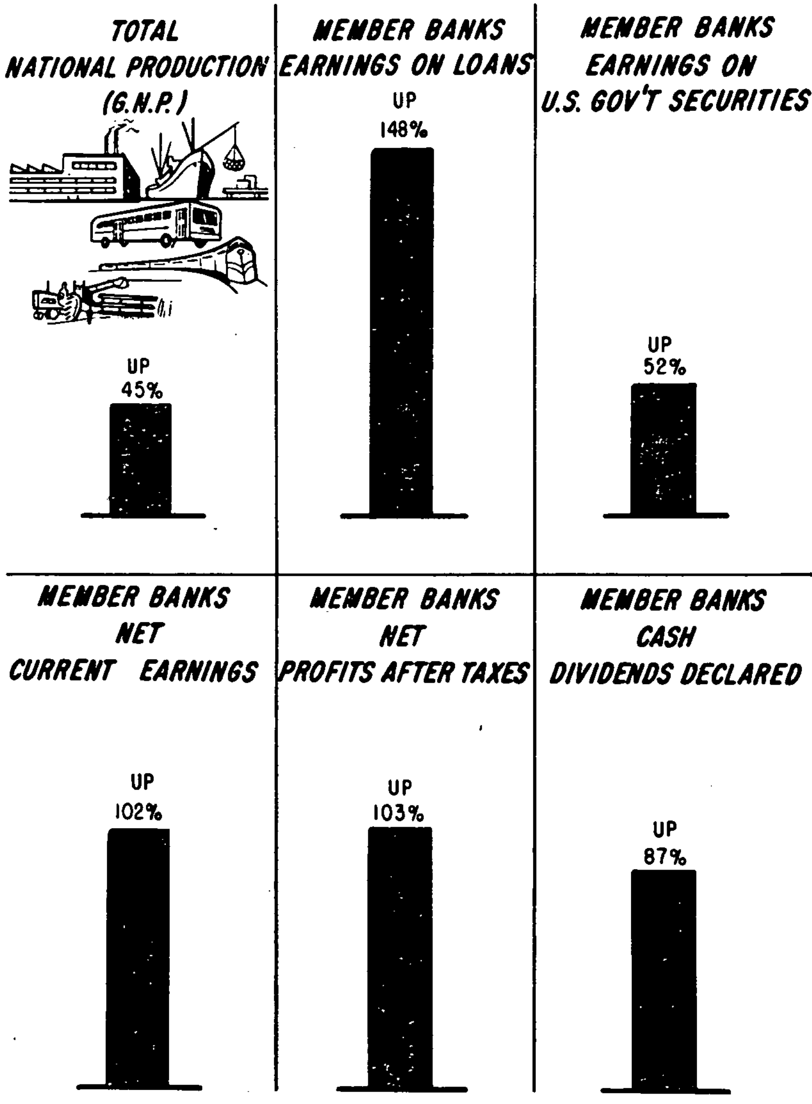


* 1961 outlays as in January 1961 budget

CHART 20

RISE IN TOTAL NATIONAL PRODUCTION AND IN EARNINGS OF FEDERAL RESERVE MEMBER BANKS, 1952-1960

In Current Dollars



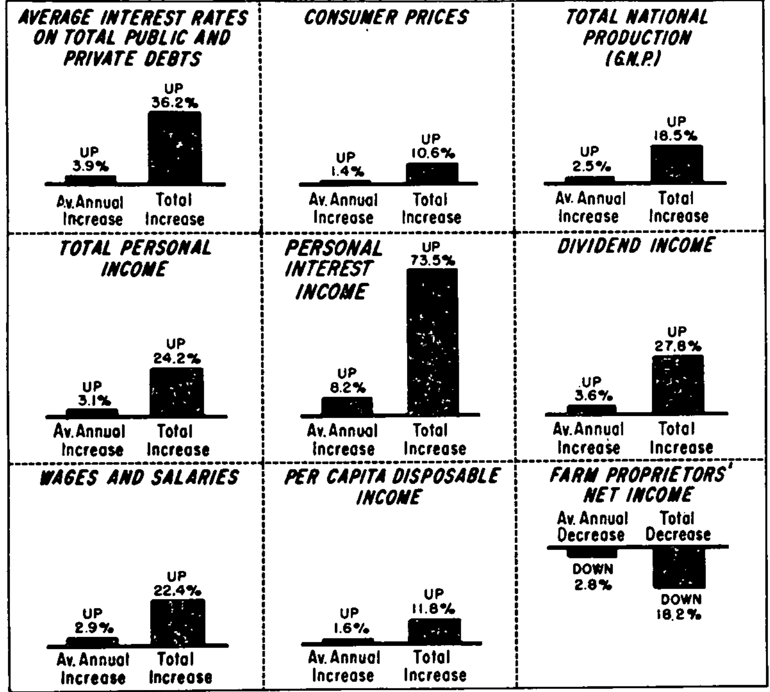
74803—61——10

CHART 21

COMPARATIVE TRENDS: INTEREST RATES, PRICES, PRODUCTION, & INCOMES, 1953-'60*

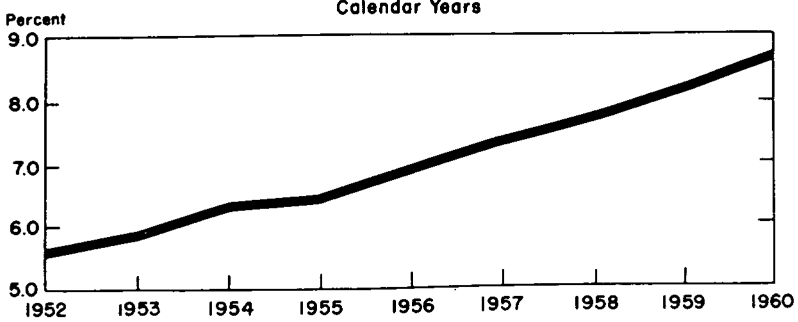
Items Other Than Interest Rates and Prices in 1959 Dollars

Calendar Years



TOTAL PUBLIC AND PRIVATE INTEREST CHARGES, 1952-1960,** STATED AS PERCENT OF TOTAL NATIONAL PRODUCTION (G.N.P.)

Calendar Years



* Interest rate trends shown for period 1952 – 1960

** Interest charges include total monetary interest paid by private business, households and institutions; exclude imputed interest.

Leaving out the importance of residential construction, which I alluded to a little while ago, I do not know what the Commission means here by "direct" effects, as distinguished from the general effects upon consumer expenditures of an unfavorable economic performance, including high-level unemployment significantly affected by monetary policy.

Despite the facts which I have already set forth regarding the fantastically low expansion of the money supply since 1953 and the dismal overall economic performance since then, the report states:

> The power of the Federal Reserve System to check the growth of the money supply or to cause it to contract must be exercised with caution. In the past the pressure has been exerted rather gradually * * * adverse reactions have probably been exaggerated.

The report does state also that the monetary restraint during 1955–57 and 1959—

> seems to have had an important effect on the level and rate of growth of economic activity.

And that is the end of that. What a marvel of understatement that is.

This is the treatment by this widely heralded study, whose very name "Commission" implies that it is vested with the aura of a sort of semipublic trust. It brushes off these vast questions, and, as I said before, I do not care particularly whether my analysis or conclusions are correct. My main point is the Commission does not even offer comparable analysis.

But presumably in order to misinterpret the inflationary problem in defense of excessive monetary restraints, the Commission devotes most of its discussion of long-run monetary policy to references to the periods 1930–46 and 1946–51—periods which were totally dissimilar in their problems and circumstances to where we are now; the first, of course, being the effort to reflate the economy after the greatest depression we had ever known, and the others all being war periods when we had a huge complex of factors bearing upon inflationary pressures, when the causes of inflation involved many other factors immensely more contributory to inflation than the monetary policy.

This sequence of treatment in the report, cavalier though it is, represents the kind of propaganda, not objective study, which has been going on.

You brush off with a light touch the idea that the monetary policy may have had something to do with the lower rate of economic growth and the higher rate of unemployment; you brush it off with a light touch by saying "it seems" in one sentence and then you are through with it. Then you push heavily on giving illustrations of entirely irrelevant periods where we had huge inflation and a large increase in the money supply, QED, the natural conclusion to be derived is that, although in recent years the monetary policy impeded the growth and lifted unemployment, we had to have it to restrain inflation.

Now, the Commission may say it did not say that, but it did not say to the contrary, and that is what the average reader or even the average informed reader, especially one who has heard so much to this effect in recent years, would gather from reading this treatment.

Passing cheerfully over the whole problem of income distribution, the Commission report says:

In general the Commission sees no reason to object to the use of monetary policy relative to tax policy on account of its differential impacts among sectors of the economy or size of business, or its direct income distribution effects.

Now, I am not going to make a flag-waving speech here about income distribution, but I am very unhappy about the fact that years ago American economists were very concerned with this problem, but are neglecting it today.

I say categorically that, whatever results you may come up with, you cannot make what I would call a responsible analysis of how the economy is functioning without getting quite profoundly into the question of income distribution in the United States, not just as a human problem, not just as a social problem, but as an economic problem.

Taxation does not avoid this question. Every tax is geared to income, not only ad hoc taxes, but also general taxes.

As against all of these sins of omission, what does the Commission report of an affirmative character? It offers some useful tidying-up and improvements in the structure of the Federal Reserve System, which would improve its capacity to employ a proper and effective monetary policy if it were prone to do so on other grounds. I certainly have no objection to this tidying-up and I favor some of the proposals, but they are millions of miles afield from the real problem of what kind of monetary policy we ought to have and how we can get it, and whether the kind we have now is seriously in need of reconstruction and redirection.

To illustrate, I favor the proposals that the open market policy of the Federal Reserve System be determined by the Board; that rediscount rates be uniform and vested in the Board; and that the determination of reserve requirements remain with the Board.

I also think that the rediscount rate should be rather more closely related to Treasury bill rates, for reasons having to do with consistency of policy.

I favor the recommendation that the periods of the Chairman and Vice Chairman of the Federal Reserve Board be made coextensive with the term of the President. But if they should be independent, they should not be coextensive; and if they should not be independent, then the President should be able to fire the man he hires, because the President is simply not in the position to know what a man he appoints is going to do, and once you go so far as to admit logically that the terms should be coterminous—and I am not here arguing for or against that—then you are admitting that the President should have the kind of man he wants.

There have been too many instances, in my own experience, when the President did not get the kind of man he wanted, and this has nothing to do with who is the right man. The President got men who immediately started moving in the opposite direction from which the President wanted them to move. This may turn out good or bad in a particular instance. But then one should not recommend that the terms should be coterminous.

The President should have the powers of the Presidency when he is President, and not just the day he appoints people.

Even in the narrow areas marked out for its recommendations, some of the detailed recommendations of the Commission would weaken the instrumentalities for an effective monetary policy. These include the recommendation that reserve requirements be used more sparingly. Now, I admit that open market operations may be more powerful and effective, but I think they may need to be used. I do not know why they should be used more sparingly.

Then there is the recommendation that there should be decreased reliance on the "bills only" policy; I believe that there should be no reliance on a bills only policy; if I read English correctly, I do not know how you can have decreased reliance on a bills only policy. I think this is fuzzy, and I think much of the fuzziness is due to unwillingness to come out clearly and vigorously.

Then there is the recommendation that the scope of the Federal Reserve System should be extended only to insured commercial banks, and not to all commercial banks and to the nonbanking structure. I believe it should be more broadly extended to them all.

As against these small stabs in the right or the wrong direction—by "small stabs," I mean tidying-up things that could be important, may be important, but really do not get to the heart of the monetary policy. The Commission report as a whole impacts quite strongly against the use of selective credit controls.

This shows, in my judgment—and here is where previous parts of my testimony would seem relevant—almost total unawareness of the extent to which our recent economic experiences demonstrate the inadequacies of general measures which are not discriminating enough to focus upon achieving desirable changes in specific resources uses before they result in undesirable changes.

I remember some years ago, I was before a committee discussing housing with the Chairman of the Federal Reserve Board, and I was pointing out that certain restrictive general policies had been put into effect, and that by any economic analysis that seemed meritorious they were hitting the wrong things first and hardly touching the right things at all.

They were hitting housing first; they were hitting State and local borrowing first. They were hardly touching the investment boom, and so forth and so on.

And the Chairman of Federal Reserve said:

"Well, you want to manage the economy; we want a free society."

Well, if that is a satisfactory answer, then I am now in India, not in Washington, D.C.

This deficiency reflects the all-too-general tendency of traditional economics to look only at the problem of so-called insufficiencies or excesses in aggregate demand, instead of recognizing that the real problem of economic equilibrium and progress depends more largely upon relationships of various types of demand within the structure, which I tried to illustrate with my quantitative analysis.

A final example of moving in the wrong direction seems to me to be this:

I do not favor, under foreseeable circumstances, the degree of support by the Federal Reserve System of Treasury operations which were characteristic of wartime, including the so-called pegging of the Government bond market.

But I certainly do believe that the Federal Reserve System should accord far more support to Treasury operations than it has been doing in recent years, and that the failure of the report to say anything to this effect was most unfortunate.

So much for what the Commission report draws from the experience of the past—very little.

What guidance does it offer for the future? Even less. For just as the report does not really analyze where we have been, it does not really analyze where we are now, where we seem to be headed, and what we should do about it. And, again, in order to contrast the monetary proposals set forth in the report with what would seem to me sound and sufficient monetary policies, I must offer my views as to the current economic situation and the economic outlook both short-range and longer-range.

The mild changes in national economic programs and policies which have recently occurred, and those thus far offered by the administration but not yet acted upon by the Congress, seem to me for the most part desirable. But I do not find them adequate to offer any large likelihood that our economic performance during the next few years will average appreciably better than since 1953. This may be too dismal a view, although in 1954 I correctly projected the low rates of growth and their main consequences through 1960.

Senator DOUGLAS. Let me say, Mr. Keyserling, your statement at this point is correct. I remember your speaking in 1954 on this very point. I thought you were exaggerating the dangers at the time.

I think the general line of your predictions has been borne out by events.

Mr. KEYSERLING. Thank you, sir.

If I should turn out to be nearly right once again—and I hope I am not—that is the one thing I learned from George Norris. He used to say on the floor of the Senate, "I may be wrong but I think I am right," and he always said what he thought was right.

If I should turn out to be nearly right once again, we would forfeit, during the period 1961–65 inclusive, about $390 billion worth of total national production and about 20 million man-years of employment opportunity. These and other consequences are shown in chart 22.[6]

In chart 23, I have taken the whole picture of employment and unemployment in the United States, broken it down into its major sectors, examined it historically, including the differing technological trends, combined this with a picture of the likely pattern of the changes in consumer and other demands as tastes shift, and thereby projected alternative employment trends under high and low overall growth rates (5 percent versus 2½ percent) from 1960 through 1965.

First of all, as shown by the left-hand corner at the top, with a repetition of the low overall growth rate, total civilian employment by 1965 would, in my estimate, be only 4.3 percent higher than in 1960. It ought to be 13 percent higher. As shown in the right-hand corner at the bottom, total unemployment would, in my estimate, be 77 percent higher in 1965 than in 1960. It ought to be 44 percent lower. I have projected this into various sectors of employment and unemployment, showing that with the low growth rate, not only would unemployment be higher, but actually employment would decrease in absolute terms in some of our most basic industries, including manufacturing and various others.

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[6] Charts 22 and 23 appear at pp. 146 and 147.

In other words, we not only would have a higher rate of unemployment growing from the increasing labor force; we would also have an absolute downturn in employment in many basic industries. And, of course, this is not striking, because since 1953 or 1954, we have had a downturn in basic full-time unemployment, I think throughout manufacturing, and it has not been absorbed elsewhere.

The reasons for my pessimisim, in the absence of much more vigorous programs, are these:

None of the fundamental distortions and imbalances in the economy have been addressed vigorously, including, I might say, those resulting from monetary policy.

The automatic stabilizers on which we place so much reliance are weaker, relative to the size of the economy, than they were in 1953. The cumulative backlogs of need, resulting from the great depression and World War II are relatively less extensive than in 1953. The new technology is advancing at an accelerating rate; and economists have persistently underestimated this advance in recent years by confusing the advance in our technological productivity potential with the retarded rate of advance in actual productivity due to the large and growing economic slack.

That sounds sort of complicated, but it is simple. When a steel mill is operating at 50 percent of capacity and retaining 70 percent of its workers, you get a low productivity figure by dividing the hours of work into the units of output. But this has little to do with the technological changes in that plant.

And as people have watched the lower productivity figures resulting from the academic slack, they have said productivity is low. But it is the technological productivity change which really presents the long-range problem if you do not use it; this cannot be swept under the rug forever; and now murder is outing, and I submit it is going to out much more over the next 4 or 5 years, and we see this in the new productivity figures, so we face a much bigger problem over the next few years.

The current upturn seems to be no stronger, at best, than previous upturns which quickly terminated. The economy in the first half of 1961 as a whole barely missed retaining the first half of 1960 level. The rather vigorous upturn since early in 1961 has not reduced unemployment at all; long-term unemployment is more serious: that is, those who have been unemployed for long periods of time.

My estimate now is that the overall growth rate from 1960 as a whole, to 1961 as a whole, will be only in the neighborhood of 2.5 percent.

Senator DOUGLAS. Mr. Keyserling, may I ask a question here?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. What is your assumption on the gross national product, 1960, versus the final quarter of 1961? It was $496 billion for the first quarter; $510 billion for the second quarter. What does that mean?

Mr. KEYSERLING. First of all, Senator, these figures that I am giving are in uniform 1959 prices.

Senator DOUGLAS. 1959 prices?

Mr. KEYSERLING. Because I have been measuring the growth rate throughout in uniform 1959 prices.

CHART 22

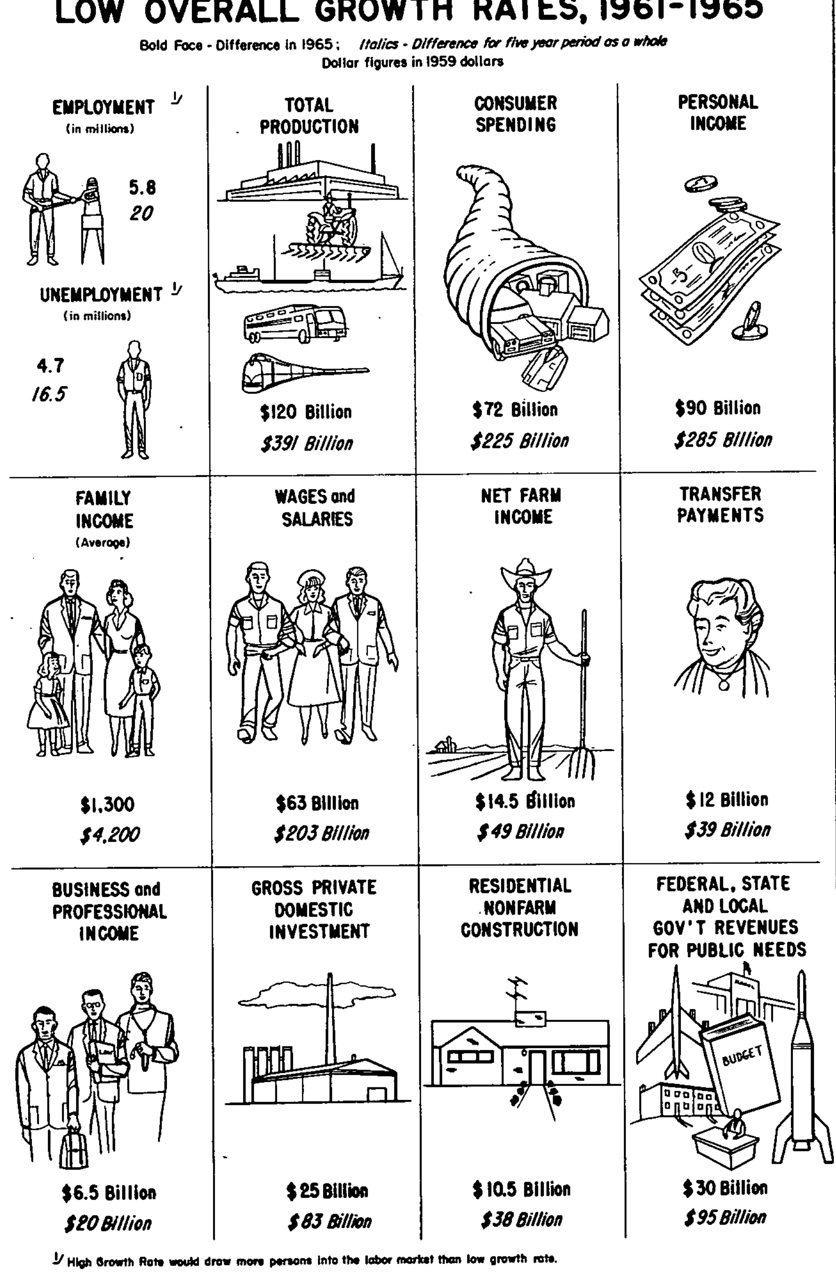
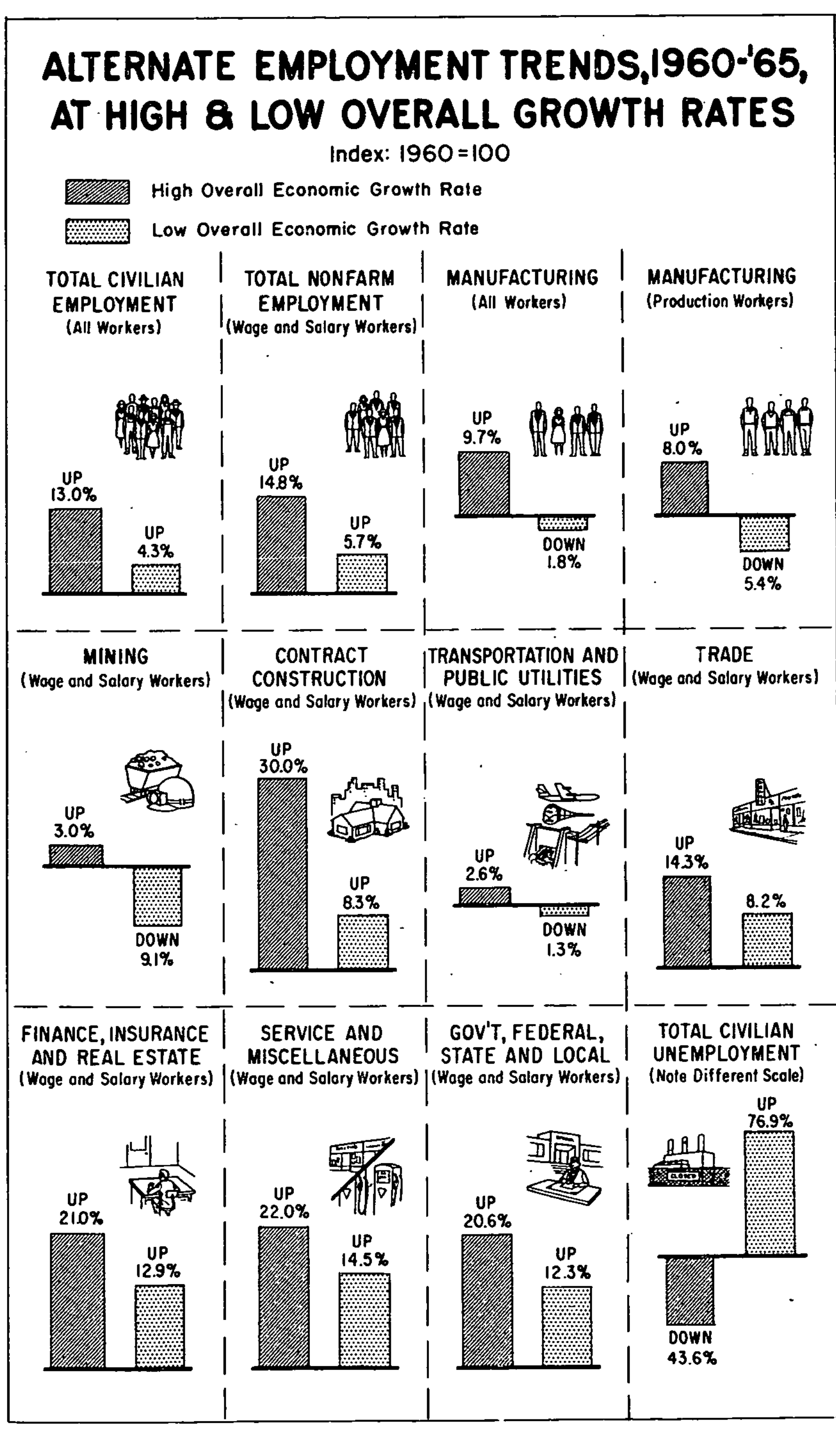


CHART 23



Second, I do not have the breakdown here, but I would be glad to give it to you.

Senator DOUGLAS. Would that be about $540 billion for the final——

Mr. KEYSERLING. Larry, do you happen to recall that?

Mr. LEONARD. In 1959 dollars, sir?

Senator DOUGLAS. Yes.

Mr. LEONARD. I would have to check the details.

Mr. KEYSERLING. I can give you the breakdown quarter by quarter, but I may say on this particular point my estimate is not much different from that of most others who are now estimating the trends in 1961.

In other words, on this particular point my estimate and that of the Council of Economic Advisers would not vary at all significantly.

Senator DOUGLAS. That seems a high total. What percentage unemployment do you think this would——

Mr. KEYSERLING. You mean the growth?

Senator DOUGLAS. The final quarter.

Mr. KEYSERLING. The growth of 2.5 percent from 1959 to 1960 seems high?

Senator DOUGLAS. No; the total seems high.

Mr. KEYSERLING. You mean the total for the fourth quarter?

Senator DOUGLAS. Because your figure is for 1961 as a whole.

Mr. KEYSERLING. Yes.

Senator DOUGLAS. As compared with——

Mr. KEYSERLING. Yes; with 1960 as a whole.

Senator DOUGLAS. 1959 as a whole.

Mr. KEYSERLING. 1960 as a whole.

Senator DOUGLAS. And, of course, the first quarter is a very disappointing quarter, and even in the second quarter you come to about $503 billion in terms of 1960 prices. I suppose in terms of 1959 prices that would be $510 billion?

Mr. KEYSERLING. Senator, I will give you today the detailed breakdown both in 1959 dollars and in 1960 dollars, quarter by quarter.

Senator DOUGLAS. Yes.

Mr. KEYSERLING. Of the 1961 estimates from which this 2.5 figure is derived.

Gross national product—based on latest data

[In billions]

Gross national product	1959 dollar	1960 dollar	Gross national product	1959 dollar	1960 dollar
1960	496.8	504.4	1961	508.3	516.0
1st quarter	496.9	504.5	1st quarter	488.7	496.1
2d quarter	500.0	507.6	2d quarter	502.6	510.3
3d quarter	496.5	504.1	3d quarter (estimated)	514.7	522.5
4th quarter	493.7	501.2	4th quarter (estimated)	527.0	535.0

Senator DOUGLAS. It seems to me, after making some rough computations which allow for an increase in the third quarter, that there would have to be a fourth quarter figure somewhere between $530 and $540 billion, and I was facing this quection:

Does this mean an appreciable reduction in unemployment by the end of the year?

Mr. KEYSERLING. I would answer that this way:

Within periods of 2 or 3 months, in other words, when you say "by the end of the year," you may mean 1 week or 1 month or 2 months, and I think we are going to have some more or less erratic short-run changes in the level of unemployment. But this might be a more general and at the same time a more satisfactory answer to your question. Implicit in my whole analysis is that if you look ahead even to the end of 1962, I would not expect unemployment to be very much lower than it is now, unless more vigorous programs are adopted. And I think this really answers your question in a practical way. And by the end of 1962, I would expect our unused resources relative to our technological and productivity potentials to be almost as high as now.

And even this is not really an adequate measurement, because when we say that at the peak of an assumed upswing we are going to be better off than when we are near the trough of a recession, it does not mean very much.

If I measured any projection of how much unemployment of plant and manpower we are likely to have at the end of 1962, assuming that that is near the peak of the boom, against the peak of the boom in 1959 or the peak of the boom in 1955, I would get an accelerated corroboration of the thesis which I have been developing now for 8 or 9 years:

That we are moving in a long-term trend toward higher and higher unused resources with short-term abberations.

Chairman PATMAN. Mr. Keyserling, may I interrupt you.

I must leave to go to the floor of the House. Senator Douglas has kindly agreed to act as chairman. I would like to know about your charts. Can you make copies available for the record?

Mr. KEYSERLING. Yes; I can. I only have one more page here.

Chairman PATMAN. Without objection we will place the charts in the record.

Mr. KEYSERLING. I call attention to chart 24, which indicates needed expansions in various sectors in 1961 and 1962 (consistent with goals I have developed through 1965), in order to restore reasonably full employment by the end of 1962, and reasonably full employment shortly thereafter. I do not believe that programs now actively under consideration will carry us anywhere near to these goals.

CHART 24

GOALS FOR 1961 AND 1962, CONSISTENT WITH LONG-RANGE GOALS THROUGH 1965

Calendar Years; 1961 and 1962 Goals Compared With 4th Quarter of 1960 Actual (Annual Rate, Seasonally Adjusted)

EMPLOYMENT (in millions)
UP 2.4 — 1961
UP 4.3 — 1962

UNEMPLOYMENT (in millions)
1961 — DOWN 1.6
1962 — DOWN 2.2
CLOSED

TOTAL PRODUCTION
UP $44 Billion — 1961
UP $86 Billion — 1962

CONSUMER SPENDING
UP $20 Billion — 1961
UP $46 Billion — 1962

FAMILY INCOME (Average)
UP $500 — 1961
UP $800 — 1962

WAGES and SALARIES
UP $22 Billion — 1961
UP $43 Billion — 1962

NET FARM INCOME
UP $2 Billion — 1961
UP $6 Billion — 1962

TRANSFER PAYMENTS
UP $3 Billion — 1961
UP $8 Billion — 1962

BUSINESS and PROFESSIONAL INCOME
UP $2 Billion — 1961
UP $4 Billion — 1962

GROSS PRIVATE DOMESTIC INVESTMENT
UP $15 Billion — 1961
UP $23 Billion — 1962

RESIDENTIAL NONFARM CONSTRUCTION
UP $5 Billion — 1961
UP $8 Billion — 1962

PUBLIC OUTLAYS FOR GOODS and SERVICES (Calendar Years)
FEDERAL
UP $7.7 Billion — 1961
UP $13.7 Billion — 1962
STATE and LOCAL
UP $2.1 Billion — 1961
UP $4.2 Billion — 1962

Chairman PATMAN. Thank you, sir.

Mr. KEYSERLING. I see nothing in the contours of the current upturn, which I have already projected through 1962, to indicate that it is unlikely to be followed by another stagnation and then another recession—unless there are vigorous additions to national economic policies.

The general reactions to the proposed new defense spending confirms my concern.

Let me say here that I am not making any guess as to what would happen either to defense spending or to anything else if the increasingly serious or at least apparently increasingly serious situation in Europe changes. I cannot do that, neither can any economist. We would be in an entirely different geometry and everything would be different. So I am now talking about the increases in defense spending which the President has thus far proposed as they would enter into the budget and into the economy over the next year or two.

The general reactions to the proposed new defense spending confirms my concern. Realistically, these proposed increases in the Federal budget are small, relative to the huge slack in our resource use. I am not talking about whether they are right or wrong for other reasons. Yet we once again hear the hue and cry of inflationary dangers, although these cries contribute to the only kind of inflation which may be in the cards by misappraising the economic situation and conjuring up the pressures and shortages which will not in fact exist unless proposed programs are stepped upward very sharply. The Government and others are in a retrenchment mood similar to that which nipped other recent upturns before we got anywhere near full use of our resources.

Turning again to monetary policy, we seem thus far to have learned next to nothing—and the Commission report does not help us. The money supply grew only 1.7 percent from July 1960, to July 1961; it did not grow as much as 2 percent from any one of the first 7 months in 1960 to the same month in 1961. And now again we hear of determination to tighten up the monetary policy and raise interest rates further in order to meet problems about as real as those which led to the damaging tightening during other upturns in recent years, which proved abortive and which ended at points further away from full use of our resources than their predecessors.

Interest rates on long-term U.S. bonds in 1961—and here is where the concentration upon the reduction of rates is supposed to be focused—thus far have averaged almost as high as in 1959 or 1960, and very much higher than in any previous year in this generation.

In other words, if we adjust for the fact that they swing down somewhat in recessionary periods, the long-term trend has continued to be upward. And the signs now are that these rates will again be climbing. Somewhat the same thing is true of State and local interest rates.

In short, our basic monetary policy is practically the same as it has been since 1952.

The argument that we must pursue a tight money policy because of the international balance-of-payments problem, even if this runs counter to our domestic economic needs, is filled with errors which I cannot discuss fully now. In the final analysis, this error reflects our

dangerous unwillingness to analyze our resources and needs and allocation problems in terms of real wealth, and to use the tools of fiscal and monetary policy, and also price and wage policies, to call the real wealth forth and to use it wisely.

Instead, like the Commission report, we are prone to debate about the theoretical usages and consequences of the tools rather than apply them to comprehensively defined real objectives geared to our capabilities and our needs.

In conclusion, we cannot achieve a realistic and optimum monetary policy until we forge that kind of overall economic policy. When we budget and project our real resources and needs to the extent intended by the Employment Act of 1946, and adjust every national economic policy to an explicit and quantitative tableau of our capabilities and goals—only then can we pursue a course attuned to survival in the space age. And only then will we be able to develop a nationwide monetary policy worthy of the name, turned from an opponent to a servant of our imperative purposes as a nation and a people in these critical times.

Senator DOUGLAS. Thank you very much, Mr. Keyserling.

Do you have any estimates as to the approximate percentage of idle capacity of capital equipment of the country ?

Mr. KEYSERLING. Yes, sir.

Will you turn back for a moment to one of these charts? In summary, I made the point that in a sense this talk about technological displacement of men by machines is misleading. In one sense, if your labor force and your technology grow faster than your economy expands, you will have unemployment, but if this were the only thing happening, the machines would be displacing the men, and we would not have idle machines. But we do have the idle machines.

This chart shows, looking at the whole period from 1954 through 1960, and through a wide range of very representative key industries, that the percentage of idle capacity was, I might say, staggeringly high, not just in the year 1960, but for the whole period 1954 through 1960.

Senator DOUGLAS. I have some difficulty in reading without glasses. Is that 23 percent idle capacity?

Mr. KEYSERLING. The idle capacity for iron and steel——

Senator DOUGLAS. I mean the overall figure.

Mr. KEYSERLING. The plant capacity idle in the basic sectors in late 1960, industrial production capacity, 12 percent; manufacturing capacity, 23 percent.

But these figures for the various areas show that for steel it was 48 percent; for nonelectrical machinery, 28 percent; for electrical machinery, 26 percent. In other words, very high in the key industries.

Senator DOUGLAS. If all the unemployed labor were put to work on all the unemployed capital, would we have idle capital, so to speak?

I figure that the percentage of lost time, involuntary lost time, is now about 10 percent.

Mr. KEYSERLING. I think that is a very good figure.

Senator DOUGLAS. If you compute the unemployment not on the basis of the total working force, but on those who seek wage and salary labor and also who have involuntary part part-time employ-

ment, it comes to about 7 percent of the 61 million who seek wages and salaries as labor.

If all the unemployment were abolished, you would still have about 13 percent idle capacity, would you not; that is, if you have 23 percent idle capacity and 10 percent unemployment, the complete abolition of unemployment would still leave you with that percent?

Mr. KEYSERLING. I think there might be several points to be made there, Senator.

In the first place, in taking what I may call the simplest point first, if we reduce the idle plant capacity from 20 to 10, that would still be fine even if we did not reduce it to zero.

Senator DOUGLAS. I understand.

Mr. KEYSERLING. I will come to the other points, also.

Second, your figures might merely indicate that, due to some of the imbalances in the economy over a long period of years, we had gotten our plant capacity out of line, even measured against a full level of employment. This may have happened. That would be another possible explanation, which would fortify some of the points I have made that money policy and other policies have operated——

Senator DOUGLAS. I may say I made a very superficial study of this 35 years ago. I came to the same conclusion then as now: that even 35 years ago, if all the unemployed had been put to work, there still would have been excess capacity.

Mr. KEYSERLING. I wish that some of those same kinds of what you call a "superficial study" could be made now. It was a wonderful study. The third point is that we do need, or at least it is an asset to have, some idle plant capacity.

Senator DOUGLAS. Yes.

Mr. KEYSERLING. In fact, we might even say that it would be an asset to have some idle labor capacity, except that there we have a human element, which should be given first consideration.

Fourth, perhaps this might indicate that we need to conduct, along with other things that we are trying to do, a training and retraining of the labor force, and this would help to equate the idle plant with the idle manpower.

So I think all those things enter into the picture.

Senator DOUGLAS. Congressman Reuss?

Representative REUSS. Mr. Keyserling, some of the members of the Joint Economic Committee, including myself, have felt for some time that the sharp recessions of 1958–60 and the increasingly high plateaus of unemployment which we have had after each of them have been, in large part, the result of misguided Federal Reserve monetary policies.

I note on page 55 of the report of the CMC—I will just read this, a short selection from it—it says the following:

> The Commission believes that the restrictive monetary policies in 1955–57 and again in 1959 demonstrate that monetary policy can have a very substantial effect on the level and rate of growth and demand.

It goes on to say that the monetary restriction used in those periods caused a decline in the rate of residential construction and in business investment and in other forms of economic activity.

While the sentence or two that I have just read at the bottom of page 55 is couched in polite, even genteel language, it does say, does it not, apparently without dissent on the part of the members of the

Commission, that it was the Federal Reserve that was, in large part, responsible for two recessions and an increasing level of unemployment?

Mr. KEYSERLING. I am not sure that it says that much, nor am I sure that I would say that much. In fact, I favor, I believe essential in these times, a picture of the economy in operation which enables us to coordinate various policies in terms of an articulate picture of resource use, and there are a variety of policies that are important.

And while I would identify fiscal policy and monetary policy as the two most important aspects of national economic policy, it would not even be necessary for what I am talking about to make a qualitative judgment of which was more important. We should be using both, and really evaluate how they worked.

Now, I think that this statement here is correct in that it says that monetary policy was a factor, not wrong in not saying that it was the most important factor because it may not be, but much too weak, but wrong—and this is the main point that I made—in ending up with a sentence which brushes it off by saying "seems to have had an important effect."

This seems to me what I said is a marvel of understatement as to the effect I think it had. But I would not be prepared to say entirely or even mainly that this was the central factor in these recessions.

I think that could be——

Representative REUSS. I was not asking you to say that, nor was I suggesting that the statement on page 55 said that. What I was suggesting was that when Mr. Martin, for example, of the Federal Reserve comes up here, as he has, and attempts to suggest that the monetary policies the Fed has had in recent years have been in nowise responsible for bringing on the two recessions and the unemployment I am talking about, when he says that this is just due to certain structural factors in the unemployment picture, I suggest that this statement here, which is apparently a unanimous statement by the Commission on Money and Credit, does tend to refute that position on his part.

Mr. KEYSERLING. It tends to refute it, and I do not agree with Mr. Martin at all.

There is a poem that says, "Earth bears no balsam for mistakes." That aphorism has never been applied to Mr. Martin.

Representative REUSS. As for your statement in your testimony here this morning that the portion of the CMC report that I am quoting from is a masterpiece of understatement, I would comment by saying that: This may be so, however, sometimes understatement in economic matters is a necessary technique of getting a point across.

Mr. KEYSERLING. That is right.

This particular statement moves in the direction of supporting your position, which I think to be the correct position. That it did have an important effect.

Representative REUSS. For example, Prof. Thorstein Veblen was enabled to remain at various respectable universities for 30 or 40 years because the essentially radical things that he said were couched in prose so turgid that he got away with it. It may well be that there is more good than you have seen at first reading in the CMC report.

Mr. KEYSERLING. Maybe I should take the same advice.

Representative REUSS. No, please don't.

Yesterday, I do not know whether you were in the hearing room or not, but I had a colloquy with Mr. Marriner Eccles on another subject that has long agitated certain members of the joint committee; namely, the impact of the interest charges on the national debt on the populace of the United States. Mr. Eccles took a rather relaxed view of the incidence of the interest charge on the national debt.

For instance, he said in yesterday's record:

> I am not so concerned about the interest that the Government pays. It goes back to the economy as a whole. You look at the ownership of your bonds—

and by that he meant Government bonds—

> and you will find that they are very widely distributed, and so the interest is widely distributed. And, of course, the Government collects in taxes a substantial amount of the interest back where it is held by corporations or banks, for instance.

Would you care to comment on that proposition?

Mr. KEYSERLING. I certainly would.

Representative REUSS. Which says, in effect, that it does not matter very much.

Mr. KEYSERLING. I think that Mr. Eccles is about 100 percent wrong on that, because if you are going to take this kind of a pleasant position, prices do not make any difference, wages do not make any difference, taxes do not make any difference.

In the first instance, it can always be said that if the price is high, someone pays more and someone gets more; if the wage is lower, someone gets less wages and somebody else gets more profits, I mean in the immediate impacts; but these redistributive allocations are the whole problem of economics. And Mr. Eccles is brushing off the whole problem when he says it does not make any difference, because whatever somebody pays, somebody else gets. Why shouldn't the interest rate then be 40 percent, because whatever somebody pays, somebody else gets? I think this argument is completely wrong.

And as to its impact on the national debt, this is entirely wrong, too. Insofar as we are trying to accomplish certain national objectives within a popular consensus of what the size of the debt ought to be and what the size of the deficit should be, it certainly does make a difference if your interest charges on the debt are $3 or $4 billion higher than they otherwise would be because of rising interest rates.

And so that, assuming that this has no beneficial economic effect, which I do not think it has, you either have to run a $3 or $4 billion bigger deficit or spend $3 or $4 billion less.

And how Mr. Eccles or anybody else can say that has no effect, I just do not understand.

Representative REUSS. Thank you.

Senator DOUGLAS. Mr. Keyserling, I wonder if you would comment on an argument which is used by Mr. Martin and the defenders of Federal Reserve policy; namely, that while it is true that the increase in demand deposits, which is roughly synonomous with money, has been at a much lower rate than the growth of the real national product, that in practice this has been necessary to compensate for the increase in the velocity of circulation of money.

And the figures are produced indicating a great increase in velocity of circulation in the country as a whole, and especially great is the increase in velocity of circulation in New York.

Therefore, it is argued that there is an increased depth, so to speak, to each dollar of demand deposits, of money in the proper sense, than is indicated merely by changes in the quantity.

I wonder if you have any comments on that?

Mr. KEYSERLING. Yes, I do.

I think that if I tried to make a technical comment in the language of the economist's interest in this problem, it would become cumbersome, and we would get into a rather abstruse discussion, and we might prove almost whatever we wanted to. But I would comment on it in this way: I would say that the intended purport of this comment is not consistent with what has happened.

In other words, judging in terms of correlations and effects, if I heard someone say that the reduced expansion in the money supply is counteracted by the increasing velocity, I would just as a commonsense reaction take it to mean that since it was compensated by the increasing velocity, the deleterious effects which the contraction otherwise had on the economy were not present.

But the deleterious effects were present, and there seems to be quite a correlation. When we had a 4- or 5-percent average annual expansion in the money supply over a number of years, we had a reasonably adequate rate of economic growth. When we had a 1.3-percent average annual expansion of the money supply, the rate of economic growth declined.

And during the years since 1955, when the monetary expansion has been 0.8 percent, the growth rate has declined further. Now one has to base his conclusions in part upon these correlations.

Now if these people were right in what they basically contend, then the increasing velocity should have compensated for the lower rate of expansion of the money supply, and we would not have gotten the positive correlation between the contraction of the money supply and the contraction of the economy.

And another reason why I do not like Mr. Martin's argument, which is a much simpler reason, is that he is so inconsistent himself, because at one time he says that the increased velocity makes up for the contraction, and at another time he defends the contraction on the ground that the contraction is a very effective way of restraining the economy, and at another time he defends an expansion, and, inversely, this should reduce the velocity.

So whatever it suits the purpose—and I am not saying this critically as to any individual, but I find just such a fantastic medley of contradictions in this whole policy—at one time the FRB says that it has a very powerful tool, because when it contracts, the money supply, it contracts the economy. When somebody criticizes these effects, FRB says: "Well, but there is an increased velocity, so it does not work that way."

Senator DOUGLAS. I hvae a great deal of agreement with you on the statistical and historical basis, but it has always seemed to me that there was a causal connection, in turn, between restriction of the money supply and the increase in velocity and that the second followed, in part at least, from the first for this reason, if I may develop the argument for the sake of the record at least; namely, that a re-

striction upon the growth of the money supply certainly raises the rate of interest.

An increase in the rate of interest, as I see it, puts pressure upon business concerns to reduce their inventories. It also puts pressure for them to reduce the unused balances in their bank accounts which have been loaned to them by the commercial banking structure and for which a charge has been made.

The reduction in the inventory ratio and a reduction in idle bank balances necessarily means a speedup in the velocity of money, and that, therefore, the increase in the interest rates caused by the restriction upon the money supply leads to an increase in velocity, and that, therefore, the central banking authorities sometimes, in trying to restrict the total money supply by raising the interest rate directly through the rediscount mechanism, have the effect of admitting through the back door what they are trying to prevent from entering through the front door.

It leads to an increase in velocity, even though they may not be trying to restrict the growth in the total.

Mr. KEYSERLING. I think this is undoubtedly right both historically and analytically, and I would add this point to it. If it is right, sometimes the fellow who comes in through the back door may be better or worse than the fellow who comes in through the front door, if you have the choice between the two. In other words, if you have monetary control, which is a more orderly way of operating, let us say, to increase the money supply when you need it or to let it be increased indirectly through this churning process of increasing velocity, which you describe.

Senator DOUGLAS. One final question.

I have felt that a more rapid increase in the money supply and a lowering of interest rates would stimulate construction and small business, and that these effects would increase the demands for building materials and other factors, and, hence, bring a general increase in the economy and a consequent reduction in unemployment, and that for a considerable period of time this could go on without an increase in the price level.

I think it is probably true that after you get to a certain critical point, whatever that may be, in the percentage of unemployment, that the further stimulation of business, the hiring of additional workers, would not be compensated for by corresponding increases in productivity.

At this point one would get a rise in unit costs and, hence, an increase in the price level. But I have never been able to be clear in my mind as to where that critical point might be.

I wonder if you have any idea as to where it might be?

Mr. KEYSERLING. First, I would say that I want to make one thing perfectly clear: That I am not for an expansionary monetary policy at all times. I believe at times it should be restrictive, wherever that point might be. I think it needs to be more discriminating or selective for the reasons I have given.

As to the point at which the increase in construction and related activities, stimulated by lower interest rates and more lenient treatment of the money supply, would reach the so-called point where general inflationary pressures justify restraints either selective or general, I could not state generally where that would be.

I think it would be roughly correlating with when you reach what might be called the reasonably full employment level. I do not know just when that would be. I do not think it would always be the same.

I could not say it would be reached when unemployment was 2 percent of the labor force, when plant capacity was 5 percent instead of 20 or 30 percent. It would be reached somewhere. However, if you have the kind of economic policy of which I am pleading for here, which involves both description and analysis and inventory and the adjustment of policies to it, we could deal with the problem moderately well when we came to it.

The other thing I would say, which seems to me to be the thing that really matters now, and I do not want to exaggerate, short of a real change in the international situation as it bears upon what we are actually doing as against what we are talking about, I cannot see any time over the next few years where we will really be confronted with a problem of trying to restrain construction and homebuilding as against accelerating it..

And, as a matter of fact, all of the analyses I have made of the future, including the analysis of the relative unemployment trends in view of the different technologies at any assumed rate of economic development, show that we are even awake to the magnitude of the amount of housing acceleration and urban renewal that we would have to develop simply from the technological and economic point of view, aside from the fact that this is one of our great national deficiencies, to equate with the technological trends, even assuming large annual increases in defense outlays.

So I think the problem is to get a great stimulation there. And I said earlier that, during the hectic investment boom periods of 1954–56 and 1958–60, from the viewpoint of investment, that, whereas, the so-called restrictive policy operated against housing, it did not really operate against the investment boom sector very much; we would have had a much more sustainable equilibrium if it had operated the other way, namely, if more funds had flown, relatively, into housing and somewhat less into the investment boom.

Senator DOUGLAS. Thank you very much, Mr. Keyserling.

We will recess until 10 o'clock tomorrow morning, when we will meet in this same room, and the three witnesses are Mr. Nathan, who I believe is a member of the Commission, Prof. James Buchanan, and Prof. Carl Shoup.

(Whereupon, at 12:35 p.m., the hearing was adjourned, to reconvene at 10 a.m., Wednesday, August 16, 1961.)

REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

WEDNESDAY, AUGUST 16, 1961

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

The joint committee met, pursuant to recess, at 10 a.m., in room P-63, U.S. Capitol Building, the Honorable Wright Patman (chairman), presiding.

Present: Senators Douglas (cochairman), Proxmire, and Bush; Representatives Patman, Reuss, Griffiths, Curtis, and Widnall.

Also present: William Summers Johnson, executive director, and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN (presiding). The committee will please come to order.

This morning the committee continues hearings on the report of the Commission on Money and Credit.

The topic of the morning hearing is fiscal policy, which includes, of course, the Commission's tax recommendations.

We will hear first from Mr. Robert R. Nathan, who will present the Commission's views and recommendations and add any comments of his own which he cares to add.

Mr. Nathan, of course, has had a distinguished career in Government and has contributed many good ideas which have led to important improvements in the art of government, as well as in the field of economics. Mr. Nathan, incidentally, now heads his own firm of economic and legal researchers.

After Mr. Nathan's presentation, we will hear from the two distinguished university professors who are especially expert in this field of Government fiscal policy. These are Prof. James M. Buchanan of the University of Virginia and Prof. Carl S. Shoup of Columbia University.

We are very glad to have you.

Mr. Nathan, you may proceed in your own way, sir.

STATEMENT OF ROBERT R. NATHAN, ROBERT R. NATHAN ASSOCIATES, INC., WASHINGTON, D.C.

Mr. NATHAN. Thank you very much, Mr. Chairman.

I would like to read the statement I have prepared, which is a brief summary, and then to add, Mr. Chairman, some comments.

Chairman PATMAN. You may do so, sir.

Mr. NATHAN. Thank you, sir.

Chairman PATMAN. And you have permission to add to your testimony as you desire, and in correcting your transcript you may elaborate, if you desire.

Mr. NATHAN. Thank you, sir.

May I first express my appreciation for the opportunity to appear before your committee to discuss the subject of fiscal policy as presented in the report of the Commission on Money and Credit. As a member of that Commission, I want to indicate my personal gratitude to this committee for conducting a full week of hearings on the report of the Commission. The results of our 3 years of intensive effort will be rendered more meaningful by the serious consideration being given to the Commission's report by this committee.

It is my purpose in this statement to summarize briefly the observations and recommendations of the Commission in the meaningful area of fiscal policy.

If you will notice in the report, Mr. Chairman and members of the committee, all of chapter 5 is devoted to the subject of fiscal policy.

In addition, some treatment of the subject is included in chapter 2, which deals with the goals in our economy, and also chapter 9, which concerns itself with the choice and combination of policy instruments.

In this respect, Mr. Chairman, I might say that in taking up this subject of money and credit, it was early considered by the members of the Commission that there could be two extreme choices or some combination thereof in the treatment of the subject of money and credit.

One alternative would have been to define the subject quite narrowly and to have limited its consideration to central banking, commercial banking, and to savings and lending institutions, both public and private.

However, there were many on the Commission, I think it is fair to say, Mr. Chairman, most of the members of the Commission, who regarded this kind of a narrow interpretation as likely to lead to something less than a really useful, meaningful, valuable report.

It was equally recognized by the members of the Commission that some limitation of scope had to be undertaken from the very beginning. Otherwise, the report would cover such a wide range of economic activities and extend over such a wide area as to have almost no limit and result in perhaps superficial treatment, rather than thorough treatment of essential subjects.

So the Commission decided to include the important area of fiscal policy insofar as it affected and concerned our money and credit system, but to limit the treatment of fiscal policy—that is, Government expenditures and Government revenues—to those aspects which have aggregate impacts on our money and credit system and not to enter into the details of specific types of tax measures, nor specific categories of Government expenditures.

I might state that chapter 9 in the report which deals with the very critical problem of policy mix, the combination of monetary policy, credit policy, fiscal policy, is a very important one and shows how, under certain circumstances, one can relate tax policy to monetary policy to credit policy to expenditures policy, so that in given situations where there may be inflationary circumstances, the fight against inflation can be undertaken not merely by a tight monetary

policy, but also by restrictive tax measures or by Government curtailment of expenditures, or by restrictive credit policies on the part of Government lending institutions.

I emphasize this because in looking at this report of the Commission on Money and Credit, it is not entirely appropriate, nor entirely helpful, nor is the usefulness of it maximized, if the different segments such as monetary policy, fiscal policy, public lending policies are compartmentalized to too high a degree. The interrelationships of these various policies, these various policy measures must be taken into serious consideration.

I would like to deal primarily with fiscal policy first and then come back briefly to the policy mix or the policy coordination.

The Commission properly concluded that fiscal policy plays an exceedingly important role in the functioning of our economy. Increasingly we have come to recognize that the level of government expenditures, the level of Government taxation, the relationship between Government expenditures and Government revenues, that is, deficits or surpluses at different levels of economic activity, have a very meaningful, significant influence on how our economy functions.

Obviously, the level of Government expenditures and the level of taxation has a direct impact on how our resources are used.

The larger our taxes in relation to the national income, the larger public expenditures are in relation to total expenditures, then the larger is the portion of our resources used or directed by Government, and vice-versa.

Similarly, when Government revenues are in excess of Government expenditures and there are surpluses, this tends to have an anti-inflationary or deflationary impact on the level of economic activity.

When Government expenditures are in excess of the level of Government revenues and you have deficit financing, this has stimulating or inflationary or anti-deflationary impacts.

It is generally recognized that the composition of Government expenditures—that is, the purposes for which Government expenditures are made—also influences the nature and character of our economy. The level and composition of taxation also influences the level and composition of our private income and expenditures.

I cannot help but refer back to a personal experience I had many years ago in writing on the subject of taxation. The article had something to do with different taxes having different economic impacts.

One businessman's criticism was that taxation should be leveled for the purpose of revenue and for no other purpose.

This fails to recognize that different taxes have different impacts. Corporation taxes on business profits have a different impact than sales taxes, and sales taxes have a different impact than property taxes, and property taxes have a different impact than individual income taxes.

So we must recognize that Government fiscal policies—expenditures and revenues—their composition and their relationship to each other, vary significantly in influencing the level and character of our economic life, its stability, its growth. I believe that the Commission paid considerable attention, properly, to this important subject.

The Commission has concluded generally that discretionary fiscal policy—that is, purposeful changes in revenues and purposeful changes in expenditures—has not played a positive role in our economic life since the end of World War II; that if one traces the planned or purposeful changes in Government expenditures or traces the changes in Government taxation up or down, by decision and not by automatic means, the contribution of discretionary fiscal policy has not been particularly helpful to stabilization since the end of World War II.

Senator BUSH. What do you mean by "discretionary"?

Mr. NATHAN. Discretionary is by decision, by action, by legislation.

Senator BUSH. Of the Congress?

Mr. NATHAN. Of the Congress or the Executive in terms of holding back expenditures.

Senator BUSH. Yes.

Mr. NATHAN. Or, within given appropriations, accelerating spending.

Expenditures did increase, for instance, in 1950, under the impact of Korea. This came fairly late in the recovery from the 1948–49 recession, but it certainly was not an undertaking related to stimulation of economic activity. During these past dozen years there have been changes in expenditures due to decisions to demobilize, decisions to increase military operations, decisions to go ahead on certain programs like the highway program, decisions to cut taxes.

Generally, it appeared to the Commission, looking back over these last 15 years, that those decisions were not really guided by economic stabilization criteria.

In other words, there were other considerations. Sometimes they happened to coincide with what one would say was sound fiscal policy, but, more often, they had adverse economic consequences. On the other hand, the automatic fiscal stabilizers did play a constructive role.

By "automatic fiscal stabilizers" we mean those measures or those activities or those consequences which arise naturally or automatically in the force of economic life.

For instance, one of the most obvious automatic stabilizers is unemployment compensation. It is clear that when high levels of employment increase, unemployment benefits go down. In other words, the support by Government action diminishes as economic activity rises.

On the other hand, when we run into a recession and unemployment increases and employment decreases, then the revenue from employment insurance taxation goes down and benefit payments rise. We are drawing less buying power from the shrinking economy, and we are pouring out more buying power in the form of benefits.

Thus, the unemployment insurance system is an automatic stabilizer tending to retard during the period of growth, and tending to stimulate during the period of decline.

Similarly, income taxes are important stabilizers because they are sensitive and responsive to changes in the national income.

As a matter of fact, corporate and individual income taxes tend to fall proportionately more than the national income and rise proportionately more than the national income. Therefore, automatically

they tend to fight inflation during an inflationary period and to cushion a decline during a period of declining activity.

Senator BUSH. This would be true also of a sales tax or a production tax, would it not, Mr. Nathan?

Mr. NATHAN. It would be true to a much more limited degree, but to the extent that something rises and falls quite sensitively or more than proportionately——

Senator BUSH. More leverage in the income tax?

Mr. NATHAN. That is right.

As a matter of fact, the sales tax might fall somewhat less than the decline in national income because savings would fall more rapidly and savings would not affect sales tax receipts.

When there is a drop in national income, we note a much more sharp decline in income taxes, especially corporate profit taxes, than in sales and property taxes.

These, therefore, become important automatic stabilizers. It is the view of the Commission on Money and Credit that the automatic stabilizers are important and ought, to the extent possible, be strengthened.

It was felt by the Commission that these could be strengthened by increasing the level and duration of unemployment benefits and the taxation necessary thereto.

However, we did not go into great detail as to just what the level of unemployment compensation benefits ought to be in relation to wages, the duration of benefits, how the duration ought to vary in terms of business cycles, or the problem of standardization among the States. These were regarded as beyond the scope of the work of the Commission. But it was noted that strengthening the unemployment compensation system would add to automatic stabilizers.

In one aspect it was felt by the Commission that automatic stabilizers could not be improved significantly by changing tax structure, In other words, by changing tax structure significantly with more emphasis on one kind of tax than another, the automatic stabilizers could not be improved a great deal.

But the Commission did come to the conclusion that the automatic stabilizers could be improved if some kind of automatic flexibility were introduced into our tax system.

By "automatic flexibility," the Commission meant that tax rates might be changed automatically up or down as deflation or inflation develops. In other words, some kind of a device such as a measure of unemployment or of the national income could be used to trigger changes in tax rates. Thus when the gross national product drops X percent, there would be an automatic cut in taxation in order to give greater support to the economy greater cushioning so the economic decline would be cushioned. Or on the upside, if prices rose at a certain rate for a time or unemployment fell to a certain low point, then taxes would automatically be increased.

Senator BUSH. Did the Commission recommend that type?

Mr. NATHAN. The Commission recommended that this be investigated, Senator Bush. It did not make specific recommendations.

Senator BUSH. I would just like to say that I have not had time to read this entire report, Mr. Nathan, and I am awfully sorry. It is my fault, but we have been awfully busy down here.

So if I ask questions like that, I hope you will forgive me.

Mr. NATHAN. Senator Bush, I am very glad to elaborate. What Congressman Patman referred to is the conclusion in the view of the Commission that taxation is a proper policy or vehicle for stabilization purposes.

In other words, we should use taxation to try to fight inflation when there is excess total demand, and we should use taxation to give support to the economy when there is inadequate demand.

The Commission concluded that the kind of tax which best lends itself to the purpose of stabilization is the income tax, and especially the first bracket rate which, as you know, is 20 percent on first $2,000 of taxable income. It was the view of the Commission on Money and Credit that if we are going to vary taxation to give a shot in the arm to a depressed economy or to take some steam out of a booming economy, the best place to do that is with the first bracket income tax rate, to raise or lower the rate.

This can be done either automatically or else discretionarily by the President or else by legislation by Congress. The Commission on Money and Credit suggests that this first bracket rate of 20 percent be increased as a way to get more revenue from the public when there is inflation, excess total demand, or should be decreased in order to leave more money in the hands of the public when there is unemployment.

Senator BUSH. What was the reasoning of the Commission?

Mr. NATHAN. The reasoning was based on several considerations. Conceivably we could change the corporate tax rates. In other words, we could drop that rate 52 to 35, 40, 45 or 48 percent when there is unemployment, and we want to stimulate investment. Or we could push it up to 55, 60 or 65 percent when there is inflation and excess demand.

But the Commission felt that this would introduce a degree of uncertainty in business and a degree of disruption and lack of continuity in business decisions and planning, that it would be harmful.

One could rely on excise taxes for stabilization purposes, changing rates as economic conditions changed.

But excise taxes are difficult to bounce up and down. If one announces in advance you are going to lower an excise tax, one might as well forget about any sales in the interim weeks.

Or if one decides to increase an excise tax, one will get a huge volume of purchases in order to get in under the gun before that excise tax increase is introduced.

Senator BUSH. Was the Commission influenced in that view about the 20-percent bracket by the fact that a reduction in that would produce the largest result of any, so to speak?

Mr. NATHAN. About——

Senator BUSH. In other words, this causes me to ask a second question. How much of the income tax on individuals comes from that bracket? It is about 80 percent, is it not?

Mr. NATHAN. About 70 percent of the total individual income tax comes from this first bracket rate. Every point in that 20 percent yields over $1 billion.

Senator BUSH. It is?

Mr. NATHAN. Yes, over a billion.

It is a very high proportion, and also receipts from such a tax change react very rapidly. Because of the withholding technique, if we want to reduce taxes and have a quick impact, there is nothing that really is more rapid, in a sense, than to stop withholding or reduce withholding.

Chairman PATMAN. Discuss the raise, too.

Mr. NATHAN. It works in both directions. What the Commission said is that if we are going to have a more sensitive, a more flexible tax system for economic stability, we ought to have a policy which can work rapidly, which can be introduced temporarily, and which can be reversible; applies these three criteria: quickly applicable, temporary in nature, and reversible.

Chairman PATMAN. Who would have the power to raise or lower?

Mr. NATHAN. We suggest three alternatives, Mr. Chairman. One alternative is to make the changes automatic. The Commission recommends that this alternative be studied. The Congress could pass a law providing that every time unemployment exceeds 7 or 8 percent, or some such measure, there should then be a reduction in the first bracket income tax rate, and that every time unemployment falls below a certain amount or the national income increases a certain amount, the rate is restored.

And if unemployment gets very low and prices rise, then rates would be increased to more than the 20 percent. That is one alternative.

Chairman PATMAN. You say "they." Who will make the decision?

Mr. NATHAN. This decision would be based on legislation and would then become automatic, Congressman Patman.

Chairman PATMAN. Who do you recommend have the decision-making power?

Mr. NATHAN. There would be nobody who would have the decision because it would be automatic, Congressman Patman, based on the criteria set forth in the law enacted by Congress.

Chairman PATMAN. You would write it right into the law?

Mr. NATHAN. That is what would make it automatic, that is correct.

Now, the second alternative, of course, is the present procedure whereby Congress raises or lowers taxes. But we recognize an important third alternative, which we do recommend in the Commission report, namely:

That Congress delegate limited, conditional authority to the President of the United States so that when he finds that circumstances are moving contrary to the well-being and the objectives of the country in terms of either inflation or deflation, he has the authority to raise or lower this 20-percent level by 5 points, down to 15 percent, up to as high as 25 percent, and that this authority be limited to 6 months, unless renewed by the President or extended by the Congress.

And that there be provision that when the President announces his decision Congress be given 60 days within which to veto the decision. This is a very important suggestion made by the Commission which the Commission believes would add greatly to the flexibility of our tax system.

Senator BUSH. That is on the Presidential authority?

Mr. NATHAN. That is right, sir.

Senator BUSH. Was the Commission more favorable to that than to the automatic push-button thing?

Mr. NATHAN. Yes.

The Commission recommended only study and investigation of the automatic approach, Senator Bush.

Senator BUSH. But it recommended legislation giving the President this discretionary power?

Mr. NATHAN. That is correct, sir.

Chairman PATMAN. Did you give consideration to giving the President that power, if the budget is unbalanced, when the Congress adjourns, to balance the budget?

Mr. NATHAN. You mean whether or not the budget is unbalanced?

Chairman PATMAN. No. If the budget is unbalanced, if the Congress appropriates more money.

Mr. NATHAN. No.

Chairman PATMAN. Do you not think that would be worthy of consideration?

Mr. NATHAN. I would doubt it, Mr. Patman. If I understand you correctly, it would be saying to the Congress that if you expend more than you expected in revenue, then the President ought to become your discipliner.

Chairman PATMAN. That is right. Congress could adjust it later on, if Congress wanted to. A 6-month provision——

Mr. NATHAN. What this would do, Congressman Patman, I think, would go beyond what we have in mind. Our thought is mainly to introduce flexibility for stabilization purposes. Now, there is no doubt that a budget balance or budget deficit or budget surplus, affects economic activity. This is clear.

And, of course, if Congress were to purposefully design an increase in expenditures for economic or other objectives, it seems to me that Congress really ought not then give away its responsibility with respect to its own fiscal objectives, whether it wants a deficit or not.

You see, what we are proposing is for a very limited purpose: Just to try to avoid inflation or try to avoid a continued decline in business.

Chairman PATMAN. A balanced budget is very important in that direction, is it not?

Mr. NATHAN. It is very important, but a balanced budget may be the result of several factors.

It may be a result of increased expenditures. To give you an illustration, if I may, let us assume that during a period of declining activity, Congress decided to fight the recession through increased expenditures; that is, expend more for certain purpose; and that would assuredly bring on a deficit and Congress planned that result. Then they adjourned.

Chairman PATMAN. That is when times are bad. I am talking about when times are good.

Mr. NATHAN. We feel at that time that Congress should pursue a budget surplus or at least a balanced budget during periods of low levels of unemployment. In periods of excess demand, it is essential as an anti-inflationary measure to pursue a restrictive fiscal policy.

Chairman PATMAN. Mrs. Griffiths wants to ask a question.

Representative GRIFFITHS. May I ask you: Did the Commission ever think of asking the President or an ex-President if he alone would like to have the power to raise taxes?

Mr. NATHAN. No, the Commission did not.

Representative GRIFFITHS. As a practical matter, do you think any President would care to exercise it?

Mr. NATHAN. I think within the measures we propose, Mrs. Griffiths, where it would be temporary——

Representative GRIFFITHS. And it was his second term?

Mr. NATHAN. No, not necessarily. You are probably thinking only about the increase in tax rates now.

Representative GRIFFITHS. Yes.

Mr. NATHAN. I think they would probably be more inclined to cut taxes than to increase them. Of course, what we are faced with here is that we have a very powerful stabilization instrument in taxation and it should be used constructively and wisely, but it should be used. When we increase taxes, it is clear, economically, we take money from the public in increased amounts. This can be a tremendously important anti-inflationary measure.

Similarly, when there is inadequate demand and we have unemployment, the reduction in taxation is a very powerful stimulating force.

The problem is: Is this force going to be used effectively and quickly to reverse a downward trend or a strong inflationary trend?

It is the view of the Commission that this delegation of authority in limited degree to carry first bracket income tax rates to the President, which is a great responsibility, would lend greater strength and yield better results in our stabilization program.

This, I think, is perhaps the Commission's most important single tax proposal.

Chairman PATMAN. May I pursue just a minute, if you please, Mr. Nathan, this point that I brought up. I am interested in the Commission recommendation on that question of tax policy.

It would cut tax rates in time of recessions when incomes fall.

Mr. NATHAN. Right, sir.

Chairman PATMAN. And raise tax rates in boom periods when incomes rise.

In fact, last year I introduced a bill for this purpose, one that would give the President discretionary powers to raise or lower the rates within a range of 10 percentage points.

I must say, however, that the ideal from my point of view would be to find some way to make changes in the tax rate automatic with changes in the level of income. In other words, it seems to me that the proposal for giving the President discretionary powers results from a failure so far on the part of the thinkers in this field to come forward with a standard, or criteria, that the tax rates be tied to. I believe you have said that the Commission on Money and Credit considered the possibility of an automatic formula and felt that none would be feasible. This is dissappointing and I hope that some further exploration of this subject will be done.

The point I would like your comment on, however, is a proposed declaration of policy which was included in my bill, H.R. 12360, in the 86th Congress, 2d session. This declaration reads, as follows:

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.

In other words, the automatic stabilizers mean, that in recession periods the Government incurs a deficit and an increase in the Federal debt. In prosperious times there should therefore be an equal or greater surplus to pay off some of the debt. But under the policy of recent years what has happened is this:

As soon as business conditions start to improve the Federal Reserve people raise interest rates and income is siphoned off in this way. In other words, the money that ought to be paid in taxes to help reduce the debt goes, instead, to the banks and insurance companies and to the personal income receivers. So the idea that I am struggling with and trying to refine is one which would require the Federal authorities to raise taxes in lieu of raising interest rates.

This would not cost a great majority of the taxpayers any more than the increased interest rates cost them. Furthermore, the Federal authorities have arbitrary and discretionary powers for raising interest rates, which takes money out of most of the taxpayers' pockets, and I do not see where it would be any worse for Federal executive authorities to have the discretionary powers to raise tax rates which would also take money out of taxpayers' pockets but for the purpose of paying off the debt instead of increasing the profits of money lenders.

Mr. NATHAN. Right. There are two comments I would make, Congressman Patman.

First, that the Commission does recommend further investigation of this automatic formula, the automatic flexibility, which is what you propose; with certain rises in income, or one could use unemployment or prices, or national income; changes in the measure or measures would trigger changes in tax rates automatically.

The Commission feels that this idea ought to be investigated. They did not feel they were ready, in view of the question of the quality of data and our state of knowledge, firmly to recommend this automatic procedure, but felt it ought to be investigated.

Now, the second point you raise, Congressman Patman, concerns this question of raising taxes in periods of intensive economic activity or excess demand as one way to fight inflation rather than through monetary restraint and high interest.

Chairman PATMAN. It is the very best, is it not?

Mr. NATHAN. I think fiscal policy is a very, very important policy. It has not played as much of a role in our anti-inflation or antirecession measures as it should, and, as a matter of fact, in chapter 9 we point out very specifically—and I think the wording perhaps is not too much different from what you have said here on this particular subject—that there are choices between monetary policy or fiscal policy or mixtures and combinations.

There are a wide variety of policy alternatives.

Rising taxation and a Government surplus serve an anti-inflationary function, just as does a restrictive monetary policy. However, the two may have different consequences. We must be very careful in thinking through what we seek to achieve in fighting a runaway inflation. Where do you want the pinch to take hold? What sectors of the economy need restraint? How will different measures influence production and income and employment? Answers to these questions should determine in considerable measure whether we should rely more on fiscal policy or more on monetary policy or more on government credit policies.

I want to point out that the Commission felt very strongly, that it is important to make a distinction on the one hand between changes in basic tax policy and basic tax structure, which have long-run implications as to what we want to achieve in terms of public-private output relations, in terms of equity and incentives, and on the other hand the short-run tax changes, which are for stabilization purposes.

The Commission discussed this at great length. It expressed disagreement with many people who say that Congress cannot act quickly on tax changes up and down for stabilization purposes. The reason why it usually takes considerable time for legislating tax changes, is because there tends to be intermingling of fundamental tax policy and of tax structure changes which deal with equity and incentives and other basic matters with short-term temporary changes. If we took one kind of tax measure and made it the vehicle for stabilization purposes, then quick action could be undertaken.

And that is why the Commission felt that the individual income tax, particualrly the first 20 percent, the first bracket rate, is the most appropriate handle for stabilization action.

There is another aspect of fiscal policy which has been the subject of great discussion among economists for a long time, namely the role that Government spending plays in economic stabilization.

Fiscal policy might be described as a scissors, one edge of which is taxation or revenue and the other edge of which is Government expenditures. They may move either in relation to each other or in opposite directions or disproportionately in the same direction.

If we increase expenditures without an increase in revenue, we tend then to stimulate economic activity. If we reduce tax revenues without reducing expenditures, this stimulates activity. The opposite changes serve to fight inflation. Historically, there was a feeling among most economists that anticyclical efforts on the part of the Government ought to be concentrated in the expenditure side, i.e. when we have unemployment, we should go in for more public works or for increases in a wide variety of expenditures.

More and more economists have tended to come around to the view that for short-term stabilization purposes, the revenue side is a more important and more potent stabilization force than the expenditure side. The Commission expressed this view. But I would emphasize that this does not mean that the Commission concluded that Government expenditure policy should play no role in stabilization.

As a matter of fact, the Commission stated that better planning, 5-year capital budgeting by the Congress, a better shelf for public

works incentives to State and local units to accelerate or delay some of their projects for countercyclical purposes, would be helpful; that many things can and should be done to facilitate variations government expenditures cyclically to help achieve stabilization.

The Commission's general view is that the level of Government expenditures ought primarily be determined by our needs and capacities for public services. In other words, if we need more schools and need more hospitals and need larger, safer roads, these ought not be moved up and down generally subject to the business cycle, but, rather, should be fulfilled in accordance with our needs and capabilities. Some better planning and timing could be helpful in fighting inflation and deflation, but generally we should not subject public expenditure policy to the vagaries of the cycle.

The Commission concluded that for short-term stabilization purposes more emphasis be placed on the revenue aspect rather than on the expenditure aspect. That fiscal policy means that if we want to stop the drop in business, we should cut taxes; to fight inflation, we should increase taxes. These are not exclusive, but rather, greater emphasis on revenues than on expenditures is proposed.

The feeling of the Commission was rather strong that we need better data and budgetary instruments for stabilization planning.

It concluded that the administrative budget as were used is not adequate and appropriate for economic analyses, economic evaluations, and economic policy purposes.

The Commission did express the view that the cash consolidated budget is more useful in that it measures the total cash flow, public to private and private to public.

But even in the cash consolidated budget, there are serious deficiencies for policy purposes. It does not distinguish between expenditures which have different economic impacts. Transfer payments, like unemployment insurance and old-age pension benefits, have different impacts than Government purchases of goods and services.

Similarly, we must take account of the fact that often the impact of changing Government expenditure policy occurs before the actual additional disbursements take place.

If the Government tomorrow announced that it was going to place $10 billion worth of new orders for certain items next year, we would not have to wait until that money is paid out next year to see a tremendous increase in the demand for the raw materials and components going into these items.

We feel an analysis of the impacts resulting from commitments, obligations, authorization, plans and orders, ought to be included in the budget picture.

Chairman PATMAN. Mr. Nathan, your testimony is so interesting and so important, I do not like to mention this, but we have two other witnesses and if you will just bring up the points that you would like to be considered and insert your entire statement in the record and permit each member to interrogate you briefly, it would be appreciated.

Mr. NATHAN. I can summarize the rest of my remarks very briefly. We feel there ought to be a variety of budgets, especially a general economic budget which would project the impacts of different fiscal policies, and what the budget implications in terms of high levels of employment, so that one could judge what fiscal policy will achieve in relation to different assumptions.

Finally, we come to the subject of fiscal policy and growth. It was the feeling of the Commission on Money and Credit that fiscal policy, just as it affects cycles, just as it affects inflation and deflation, also has an important effect on economic growth.

The Commission recognizes that Government expenditures affect growth, because expenditures on education, expenditures on health, expenditures on highways, expenditures on many other services and goods increase our capacity to produce still more.

The commission importantly takes into consideration and account the fact that taxation importantly influences incentives. Certain kinds of taxes stimulate consumption; others serve as incentives to invest.

The Commission takes account of the differences of views that many people have on how the economy functions and what the forces are which stimulate or retard growth and full employment.

There are some who feel that if only we changed our tax system to take more money away from consumers and put more money into the hands of investment channels, we would enjoy more vigorous growth and a more dynamic economy.

There are others who say that the level of investment is determined primarily by the level of ultimate demand, and that no matter how much savings are made available for investment, these savings will not all be invested if there is an inadequate market for the output of our business enterprises.

And the Commission tries to indicate the fiscal policies appropriate for situations where there is an inadequacy of savings for investment and where investment demand will respond to increased savings, on the one hand, and where, on the other hand, it is necessary to stimulate consumption.

I am not going to read from the Commission's report, but I would suggest that the members of the committee might wish to review the text on pages 143, 144, and 145. It is the conclusion of the Commission that through the structure of taxation, through the level of Government spending through the surplus-deficit combinations or variations, through tax policies designed to achieve either surplus or deficit, the Government does affect our economic growth.

There are some people who feel that the relationship of Government expenditures to Government revenues under present tax rates is such as to restrict economic growth and full employment. We would have too much of a surplus at high levels of employment to make these employment levels sustainable.

There are others who feel such surpluses at full employment will merely serve to stimulate more investment.

I think the Commission does recognize this issue. It notes that, in addition to changing tax and expenditure policies for stabilization purposes, we must also take into account expenditure and tax policies with respect to economic growth, in assuring the total demand essential for longer term growth objectives.

The Commission feels that if we have inadequate demand in the economy, it is better for growth and high employment, to bring about and increase in demand by a deficit rather than by shifting our tax structure, designed to bring about a change between savings and consumer expenditures. To try to change the tax structure so as to curtail or increase demand would be very difficult.

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In other words, shifting from deficit to surplus and surplus to deficit is the most effective instrument for both stabilization and stabilization purposes.

I will repeat that the Commission takes account of the fact that Government expenditures do affect our growth by affecting the availability of resources for further production. We feel that the Government ought to make provision for research, for providing those basic services and basic assets which will make the economy function more effectively.

I would like to close, Mr. Chairman and members of the committee, by saying that, in my judgment, the Commission has performed an exceedingly useful purpose in describing illustratively how different policies may be combined, interwoven, worked together, to give us vigorous growth, sustained high levels of employment and low levels of unemployment, and price stability.

(The entire statement of Mr. Nathan is, as follows:)

STATEMENT BY ROBERT R. NATHAN FOR THE JOINT ECONOMIC COMMITTEE ON FISCAL POLICY ANALYSES AND RECOMMENDATIONS OF THE COMMISSION ON MONEY AND CREDIT

Mr. Chairman and members of the committee, may I first express my appreciation for the opportunity to appear before your committee to discuss the subject of fiscal policy as presented in the report of the Commission on Money and Credit, As a member of that Commission, I want to indicate my personal graditude to this committee for conducting a full week of hearings on the report of the Commission. The results of our 3 years of intensive effort will be rendered more meaningful by the serious consideration being given to the Commission's report by this committee.

It is my purpose in this statement to summarize briefly the observations and recommendations of the Commission in the meaningful area of fiscal policy. The entire contents of chapter 5 of the Commission report, plus parts of other chapters, especially chapters 2 and 9, deal with the subject of fiscal policy.

One of the difficult problems the Commission had to face very early in its deliberations concerned the scope of inquiry into various aspects of economic policy. The subject of money and credit could be defined narrowly to encompass only monetary and credit policies and instruments. Such a definition would have largely confined the work of the Commission to the role of central and commercial banking and various public and private credit institutions. On the other hand, to deal so narrowly with the subject of money and credit and to neglect fiscal policy would have resulted in a report and in recommendations which lacked the balance, the overall perspective, and the essential ingredients for dealing fully with the most challenging and fundamental economic problems of our time.

It was decided by the members of the Commission to consider fiscal matters to the degree necessary for a meaningful and effective evaluation of our money and credit system. However, a detailed and thorough investigation of Government taxation and expenditure policies was considered to be outside the scope and feasibility of the Commission's task.

I believe that the final results represent a desirable balance between trying to do far more than was feasible within the limits of time and resources available to the Commission and trying to concentrate only on specific and narrowly defined subjects which would have been of greatly limited value.

The Commission recognizes the important contribution which fiscal policy can make toward achieving the three basic goals of sustained high levels of employment, vigorous growth, and reasonable price stability. It was the consensus of the Commission that fiscal policy—both in the expenditure and revenue areas—can and should play a positive role in the achievement of these objectives. A vast variety of specific objectives are served by governmental expenditures and by Government revenue measures. Yet, the impacts of aggregate Government receipts and expenditures, of Government surpluses and deficits, and of the composition of both receipts and expenditures on the functioning of our

economy were fully recognized by the Commission. I believe it is fair to say that the Commission concluded that fiscal policy should seek to assure that these impacts have a positive influence on the effective functioning of our economy.

It was the Commission's view that the contribution of discretionary fiscal policy within recent years to the attainment of our economic objectives left much to be desired. Discretionary fiscal policy since the end of World War II has played a less than maximum and satisfactory role. On the other hand, automatic fiscal stabilizers did contribute significantly to the postwar record of our economy.

Progressive and responsive income taxes are recognized as important automatic stabilizers. Similarly, unemployment compensation assessments and benefits serve importantly to curb inflation and cushion declines in income. The large size of the Government expenditure program also serves to provide a degree of automatic stabilization. State and local revenues are less progressive and less responsive to changes in economic activity than Federal taxes and therefore do not serve in the same degree as Federal taxes toward supporting economic stabilization.

The Commission favors the preservation and strengthening of automatic stabilizers. This objective could be accomplished by increasing the level and duration of unemployment benefits, by revenues that are sensitive to changes in income, and by formula flexibility. It was the conclusion of the Commission that changes in tax structure needed to strengthen the automatic stabilizers substantially would not be feasible. In other words, feasible modifications in tax structure would not greatly strengthen the automatic stabilizers. However, a device of formula flexibility would be an automatic method of strengthening built-in stabilizers substantially. Since the Commission did conclude that the strengthening of built-in stabilization would be desirable and since changes in tax structure would not contribute substantially toward this objective, it recommended that formula flexibility be investigated.

Discretionary fiscal policy will continue to play an important role in our economic life. Improvement in our economic data and speed in legislative enactments and in executive implementation can serve to make discretionary fiscal policy even more effective. Speedy decisions and prompt impacts are essential.

The Commission very strongly urged that permanent and structural changes in both the revenue and expenditure aspects of fiscal policy should not be confused with temporary, reversible fiscal changes for stabilization purposes. Basic tax structure and basic Government expenditure programs should be related to longer term economic objectives, but for stabilization purposes measures should be pursued which are simple and temporary and reversible.

The Commission concluded that the tax which best fits the above criteria for flexible revenue policy is the personal income tax and that changes in the first-bracket rate would serve the above objectives most effectively. For either formula flexibility or discretionary tax adjustment the Commission recommends variations in the first-bracket rate of the personal income tax.

The Commission recommends that the President be empowered to initiate tax rate changes for stabilization purposes and that such authority be limited as to type of tax change, duration of change and size of change. Such a limited delegation of power to the President would contribute to economic stabilization.

In summarizing tax policy for stabilization purposes, the Commission concluded that (*a*) temporary and reversible changes for stabilization purposes be disassociated from permanent and structural changes; (*b*) the personal income tax is the most appropriate tax for stabilization adjustments; (*c*) the first-bracket rates offer the best basis for change; (*d*) Congress grant limited conditional power to the President to make temporary contracyclical tax adjustments and that the maximum adjustment be limited to 5 percentage points upward or downward from the present 20 percent rate, that the duration of the adjustment be limited to 6 months subject to renewal by the President or by Congress, and that the Presidential power be subject to legislative veto.

The Commission expressed greater doubts about the effectiveness of discretionary expenditure policy for stabilization purposes than of discretionary tax policies. Many Government expenditures cannot be accelerated or curtailed speedily, especially if criteria of efficiency and usefulness are strictly applied. Further, the Commission felt that Government expenditure programs should be determined by the more fundamental requirements for public services than by short-run stabilization considerations. However, better long-term planning and

budgeting for Government capital expenditures would be helpful in terms of making public expenditure policy more flexible. Incentives should be provided to State and local governments to help make their expenditure programs more effective contracyclically. Some project financing can be adapted to serve stabilization purposes.

The Commission came to the conclusion that the conventional or administrative budget is not satisfactory for fiscal stabilization decisions. The cash-consolidated budget is more suitable but even it does not fully serve the needs for effective economic policy considerations. Rather, the Commission calls for a budget as reflected in the national economic counts. Also, the budget should include projections based on assumptions of a high-employment level of income and reasonable price stability. It should facilitate analyses of the impact of fiscal policies. Further information is needed which will reveal the impact of public expenditures on an order basis.

Fiscal policy importantly influences economic growth in many ways. Government expenditures for education, health, research, transportation, and other purposes directly affect our capacity to produce. The incidence of taxation affects levels of consumer expenditure and of savings. Taxation affects incentives. Government surpluses can be regarded as public savings available for investment. Government deficits can stimulate consumption and thereby encourage capital formation. Fiscal policy must be designed not only to serve short-run stabilization purposes, but should also contribute to vigorous growth.

The Commission recommends that budget surpluses and deficits rather than changes in tax structure be relied upon to meet the needs of either increased savings or of increased consumer expenditures for increased growth and minimum unemployment. Drastic tax changes would be needed to affect significantly the levels of savings and of consumption and such changes could be far more disruptive than shifting from deficits to surpluses or vice versa.

Of course, the structure of taxation not only affects patterns of savings and consumption but also influences investment incentives. The Commission does not consider the incentive aspects of taxation in detail but does call for minimizing tax deterrents to capital formation. The interrelationship of taxation impacts on savings and on incentives is emphasized. The Commission report deals with the complexities not only of surpluses and deficits and of changes in tax structure but also with incentives and of the necessity to maintain a longer-run sustainable balance between investment and consumption.

The Commission states that public capital formation contributes to growth and notes that budget policy and economic growth are mutually related. More public capital formation will be needed as the economy grows and this growth will provide the revenue for such public capital formation. Congress should enact a program of public capital expenditures of particular importance to growth on a 5-year basis.

The Commission recomends that in budget policies high priority be given to financial provisions for basic research and training of research talent. The social costs of accelerated technical change must be taken into account in public policies.

In summary, fiscal policy can and should be so conceived, designed, and implemented as to make a significant contribution to low levels of unemployment, reasonable price stability, and vigorous growth of our economy.

Chairman PATMAN. Prof. James M. Buchanan, University of Virginia, and Prof. Charl S. Shoup, of Columbia University. We are glad to have you, gentlemen.

In the order in which I called your names, you may present your statement, and if you will summarize it and place it all in the record.

Then the members will interrogate the three of you.

STATEMENT OF JAMES M. BUCHANAN, UNIVERSITY OF VIRGINIA, PROFESSOR OF ECONOMICS AND CHAIRMAN OF THE DEPARTMENT SINCE 1956, PROFESSOR OF ECONOMICS, FLORIDA STATE UNIVERSITY, 1951–56

Mr. BUCHANAN. Thank you, Mr. Chairman.

I first should apoligize for the fact that I did not get my statement duplicated sufficiently in advance to have it circulated. I did bring with me a few copies.

Since my remarks are brief, I propose to go ahead and make these remarks here.

I shall confine my remarks here to the major recommendation on fiscal policy made by the Commission. This is the recommendation that the President be authorized to make certain changes in the first-bracket rate of personal income tax as he deems necessary for the accomplishment of countercyclical purposes.

I do not agree with this recommendation, and I do not think that its implementation would be in the national interest. I shall discuss three separate points, which may be summarized as follows.

(1) The recommendation seems to be based on the presumption that we possess a great deal more knowledge about aggregate economic fluctuations than we do, in fact, possess.

(2) The recommendation essentially ignores the realities of political process in a democratic society.

(3) The recommendation on fiscal policy reflects the Commission's failure to examine the basic issues of structural reform in monetary institutions. It proposes an extension of discretionary controls, when, in fact, such controls should be restricted and their functions replaced by more automatic or quasi-automatic institutional rules which can serve to introduce the desired predictability into the monetary sector of the economy.

1. The American economy, as it is currently organized, is characterized by fluctuations in production, employment, incomes, and prices. The separate movements up and down vary greatly in severity, in extent, in duration, in regional impact, in industrial sectors. Patterns of regularity can be detected, but these patterns are not predictable in advance. The general direction of effects of monetary-fiscal policy actions is known, but the length of time required for actions to be translated into effects is not established. Little knowledge is available to indicate the appropriate magnitude of action required to achieve a specific magnitude of effect.

If, in fact, the course of the national economy over a few months in the future could be accurately predicted, and if the time lags and the magnitudes of effects could also be predicted, there would be no need for additional instruments of control. But, since these predictions cannot be made, the provision of additional instruments of control can be of little value. Discretionary authority in the hands of the Executive will not, in and of itself, add to our knowledge of the movements in the so-called business cycle. The authority, if it were possessed, seems almost as likely to be employed in actions that would be destabilizing as in actions that would be stabilizing. The experience of the discretionary authority of the Federal Reserve Board in this respect does not demonstrate that action taken would

always be stabilizing. And, as the discussion of the next point will indicate, there are good reasons to suggest that the administrative authority of the Executive would not be used so "wisely" as that of the Federal Reserve Board. In its discussions of this recommendation, the Commission has not presented convincing evidence that discretionary fiscal authority, if granted to the President as suggested, would, on balance, lead to greater economic stabilization.

In retrospect, the wise and prudent employment of discretionary authority seems always to have much to commend it. "Had we known then what we know now" begins many a review of past events. But the Executive, like the Congress and the Federal Reserve Board, must act without the advantage of retrospection. Restrictions on knowledge in the whole area of fiscal-monetary controls seem more significant than restrictions on power.

2. The recommendation of the Commission seems to be based on the implicit assumption that "the Executive," "the Government," is, in some sense, a benevolent despot, acting bravely and courageously in the furtherance of some mystical conception of "the public interest" whereas the Congress somehow responds to crude political pressures imposed upon it by the electorate. This popular misconception should be exposed, and the realities of modern democratic process openly discussed. The Executive, as much as or more than the Congress, is subject to the electorate and seeks to satisfy this electorate. This is, of course, the point that Mrs. Griffiths was alluding to a minute ago.

When this simple point is recognized, the limitations of the Commission's recommendation become clear. Few Presidents would have the independence necessary to increase first-bracket rates in response to stabilization needs in any election year, or indeed at any other time; all Presidents would be tempted to reduce first-bracket rates in response to the slightest stabilization needs at almost any time. This is not to suggest that the Executive should possess such independence, far from it. In our society, the Executive should respond to political pressures. The fact that he does so indicates only that discretionary fiscal authority is not an appropriate Executive function.

Look at what might have happened had the President in the past possessed the proposed authority. President Eisenhower with good reason, might have lowered first-bracket rates by 5 percent, say, in September of 1960. This action would surely have been charged with partisan motivation and it might, in fact, have changed the outcome of the election. However, assume that there would have been no change in results. In March 1961, 6 months later, President Kennedy would surely not have allowed first-bracket rates to be increased; instead, the temporary reduction would have been extended. Again, in September, 6 months later, with the economy not yet at full blast, first-bracket rates would not be increased.

And so it goes. What seems evident is that the discretionary fiscal authority, as proposed specifically by the Commission, might well result in a once-and-for-all 5 percent reduction in the first bracket rate of the personal income tax. If this is the case, it would be much better to enact such a reduction directly.

There seems to be little question but that the proposed discretionary authority, if granted, would contain a strong inflationary bias, in that reductions in first-bracket rates would occur much more frequently than increases. The Federal Reserve Board's experience in countering political pressures when a policy of restraint has seemed required would be multiplied in an agency of Government that is much more political in nature and operation.

The objections raised in this section of my statement may be countered by the introduction of formula flexibility. Instead of granting authority directly to the Executive, the first-bracket rate of the income tax or across-the-board rates could be tied directly to some index of economic performance and this rate could then be allowed to move up and down, within defined limits, more or less automatically as the relevant index varies. This idea of formula flexibility has a great deal of appeal to me, or to anyone who seeks to reduce discretionary administrative authority wherever possible. Formula flexibility seems, however, to be more appropriate for monetary than for fiscal action at the present time. The interesting point here is that the Commission, in its lengthy report, most of which is on monetary policy, specifically discusses formula flexibility only with respect to fiscal policy. The Commission does not, anywhere in its report, bother to consider the appropriateness of similar formula flexibility in the operation of the monetary authority. This leads directly to my third point.

3. The fiscal policy recommendation discussed here has received more comment in the press than any other point of the Commission's report. In one sense, this recommendation is the "boldest" one made by the Commission. This is true despite the fact that the Commission's main task was that of exploring the operation of the monetary and credit system, not the fiscal system. The recommendation on fiscal policy reflects the Commission's failure to undertake more than a surface examination of the monetary system. In my opinion, the Commission has failed to explore and to examine basic issues of structural reform in the whole set of monetary institutions. This failure, in turn, can explain the recommendation on fiscal policy.

An attractive case can be made for the positive and vigorous employment of fiscal policy as a stabilization instrument if the assumption is made at the outset that no basic changes are to be made in the structure and operations of the money and credit system. Many able students, from Keynes on, have made such a case. The Commission follows in this line of thinking. This thinking reflects a failure to ask the question:

Could the same results be accomplished more effectively by changes in the "monetary constitution"? Given the absence of any specific directive or rule for the operation of the monetary authority, it is little wonder that we have had fluctuations in the economic system. Without some built-in predictability in the monetary system, such fluctuations must continue. The Commission, in my opinion, has passed over an excellent opportunity to examine the basic structure of the monetary system.

Basically, neither monetary policy nor fiscal policy is appropriately a function for discretionary authority, whether this be the Federal Reserve Board or the President. What is needed is some "rule of law,"

some quasi-constitutional, quasi-automatic, system that would introduce the predictability that is required for the complex adjustments of the thousands of private decisions made by individuals and firms in the national economy.

I do not propose to discuss here what specific changes in the "monetary constitution" should be recommended. Many proposals have been advanced, from the adoption of some fully automatic commodity standard at one extreme, through such proposals as the introduction of a fixed rate of growth in the money supply, or the explicit stabilization of some price or income index.

I emphasize here only that the Commission has been negligent in its task in not exploring carefully such proposals in greater detail and depth. Instead of exploring the means through which discretionary authority, which is necessarily unpredictable in its operations, might be reduced, the Commission, through its fiscal policy recommendation, proposes to add still further discretionary authority by yet another agency. This represents, in my opinion, a shift that is surely in the wrong direction.

Chairman PATMAN. Thank you, sir.

Our next witness is Prof. Carl S. Shoup.

Professor Shoup, we are glad to have you, sir. We look forward to hearing your testimony.

STATEMENT OF CARL S. SHOUP, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY, NEW YORK, N.Y.

Mr. SHOUP. The chapter on fiscal policy of the report of the Commission on Money and Credit seems to me to be a carefully reasoned, well-balanced analysis of countercycle fiscal policy, and I find myself in agreement with most of the Commission's recommendations in that chapter. My statement today, rather than touching on all the aspects of fiscal policy covered by the Commission, will concentrate on built-in flexibility and discretionary authority, with respect to taxation.

We may start with the principle that, although built-in flexibility is a good thing, we need not sacrifice other goals for it. After all, we have the weapon of discretionary changes, which can be made as powerful as we wish. To conclude that we need more built-in flexibility because we cannot trust ourselves to act effectively on a discretionary basis would be to imply a sort of legislative and executive paralysis that, if it really existed, would make our entire budgetary process impractical. Such a conclusion would also imply an uncertainty over the effects of fiscretionary action, an uncertainty so marked that the question would naturally follow, Why are we then so certain of the virtues of built-in flexibility? Can we be sure that the timing of built-in flexibility will always be better than the timing of discretionary action? As the Commission rightly remarks (p. 123), built-in flexibility tends to slow down the initial stages of recovery from a depression; discretionary action, by delaying a tax increase somewhat, might provide better timing at this stage.

Built-in flexibility, then, is useful, but not absolutely necessary. We can accept it gratefully when it comes in combination with other merits, or when it does not interfere with other goals. For example: I happen to favor a certain change in the personal income tax base,

namely, a carryover of unused personal exemptions. This measure is needed to equalize the tax burden between those with fluctuating low incomes and those with steady low incomes. If such a carryover took the form of a carryback rather than a carry forward, it would increase considerably the built-in flexibility of the income tax. But if this measure conflicted with our basic notions of tax equity, I should not want to recommend it.

Similarly, the structure of Federal grants to States, or credits against Federal taxes, need not be altered merely in order to gain more stabilizing power. Too many other important issues are involved in grants, credits, and State and local borrowing, issues whose outcome will be decided absolutely by decisions in these areas, while countercycle fiscal policy, to repeat, can always be obtained at the Federal level, to any desired degree, by discretionary action. If the tax systems of the States and localities are made more sensitive to business conditions, State and local borrowing must increase in depressions, and repayments must increase in other periods. If some of these governmental units found borrowing difficult in a depression, the Federal Government would have to lend, and the countercycle problem would be back in Washington; there it belongs anyway.

Built-in flexibility may be greater in one tax than in another, yet more useful in the latter tax. The corporation income tax is more sensitive to changes in national income than the personal income tax, but its revenue decrease almost surely does not stimulate private spending as much. We seek, not a decrease in tax yield as such, but a stimulation of private spending. Likewise, in estimating the effect, quantitatively, of a certain tax's built-in flexibility, we need to specify whether we are simply comparing the decline in yield with the concurrent decline in national income, or, more significantly, are estimating the amount of private spending that was maintained (directly and indirectly) because the tax yield did decline.

The past few recessions have presented us with a paradox, respecting official attitude and action at the Federal level. On the one hand, we have found Federal officials rather grateful for the countercycle influence that was being exercised automatically by declines in tax revenue and increases in transfer payments, while on the other hand they were refusing to add to this influence by discretionary action (changes in tax rates). Was the amount of countercycle pressure exerted automatically somehow just right—not too much, not too little? A more plausible explanation is the very human desire, if anything goes wrong (continued depression, or inflationary boom), to have the blame fall on impersonal mechanisms. Anyone, of course, may well be uneasy about the responsibility involved in venturing directly and consciously into countercycle policy through taxation. But sooner or later the venture will have to be made, and we might as well start practicing on a small scale without more delay. To be sure, I must admit that if the hesitancy shown in the past few depressions is symptomatic of a deeply built-in inflexibility, a refusal to take open responsibility for countercycle policy, there is nothing for it but to become as automatic as we can. I think this would be an implicit admission that we really do not believe very much in countercycle policy.

The search for formula flexibility can too easily become just a way of seeking to escape from assuming responsibility, making decisions, and learning from mistakes. Formula flexibility is a near relation of built-in flexibility; indeed, formula flexibility can be so devised that it is almost indistinguishable from built-in flexibility. Thus, in principle, the index that would trigger a decrease in the rates of an income tax could be the decrease in yield under the existing rates of the tax. For example: if the yield of the income tax decreased by, say, 10 percent as business fell off, an automatic decrease of, say, 5 percent in income tax rates would take effect. In this manner, built-in flexibility could be endowed with as powerful an impact as desired. But the built-in timelag (viz, the time elapsed until the data on yield became available) presumably makes this kind of device unsuitable.

If, as I am suggesting, we are to rely heavily on discretionary action, should the discretion rest in the hands of the executive?

We cannot say from the past record that Congress would not act with the necessary speed on an executive proposal to lower tax rates to check a recession, and to raise them when recovery had been achieved. Congress has never been faced with such a request (on a purely fiscal-policy basis, apart from war). My own tentative view is that, although it does not matter much where the discretionary power rests, if it is no larger than that suggested by the Commission of Money and Credit, and is restricted by a 60-day waiting period, we should give the existing machinery a trial before deciding whether we should move to discretionary action by the Executive. Congress would surely not try to reopen the entire tax structure on such an occasion; and I should suppose that the mechanics of getting a bill through both Houses would not prevent suitably fast action, if Congress truly agreed with the President on the need for such a measure. But we may also be reasonably certain that if the President had discretionary power, he would not abuse it for purely political ends, in view of the clearly economic aims involved.

Accordingly, the first step is for Congress, led by the Ways and Means Committee, to decide now what tax rate or rates shall be decreased when the need for such action next arises, and even stipulate now the size of the decrease, within a range. This embryonic bill could then be put on the shelf, to be brought out at the proper time. An analogy may be drawn with the mechanism of authorization followed by appropriation. Discussion over just where in the tax structure the potential reduction should be lodged could be debated and decided in prosperity, while there is still plenty of time to debate the matter (authorization stage), and the reduction could then be voted into effect promptly when the need arose (appropriation stage). If the delay in action under the present machinery proved too great, the "appropriation" stage, that is, the timing, could be left to the Executive, following the suggestion of the Commission on Money and Credit.

My analysis to this point has been in terms of measures taken during a recession and recovery. The normal schedule of tax rates is lowered temporarily, and then restored. Can we also expect to raise tax rates above their normal, stable full-economy level in order to check inflationary pressures originating in the private sector?

Here, it seems to me, we can be much less certain what we want to do. Taxpayers will protest that the private sector would not be initiating inflation if monetary instruments were being handled properly. They will ask why they should sacrifice, through higher taxes, so that plant and equipment expansion, inventory building, and installment buying may proceed unchecked. If the private-sector inflation is said to be due, not to excessive credit, but, say, to a wage-price spiral, the taxpayer will ask, first, can an increase in taxes really stop that kind of private inflation? And second, why should not the parties who are causing the damage be directly restrained, in place of asking the taxpayers to hold the lid down? In Britain, to be sure, this kind of tax increase has proved politically possible, but I believe we need to think more about these issues before we decide whether a tax increase above the standard full-employment level should be discretionary with the Executive.

The specific measure proposed by the Commission, namely, a change in the lowest bracket rate of the personal income tax, is probably as good as any (for married taxpayers this is a $4,000 bracket; the Commission's $2,000 figure on p. 134 is evidently for a single person). However, a change limited to 5 percentage points seems rather modest. If the full change were kept in effect for an entire year, the direct increase in consumer disposable income, not over $10 billion, would not be large, in an economy where total personal disposable income is near $360 billion. The indirect, or multiplier, effects will of course be substantial, but we need to be prepared for the possibility that the spending reaction of the tax-relief beneficiaries will be on the weak side (though the subsequent multiplier effects might be at a normal level). The consumer-taxpayer will be trying to estimate how long the depression will last. Whatever his estimate, he will not be strongly stimulated to spend most of his tax relief. If he thinks that business is going to recover shortly, he will view the tax relief as only a short-period windfall; many families will not expand their consumption appreciably on such a basis. If he thinks that recovery is still some distance away, he may try to save against the day when he too may become unemployed (the tax relief, by and large, will go to those who for the moment still have jobs). All this is not to argue against tax reduction to counter a recession; it is to say, rather, that if we go at it too gingerly we may be greatly disappointed, and unjustifiably conclude that there is nothing to the idea after all.

Just this year, the United Kingdom Parliament has granted the Chancellor of the Exchequer, at his request, until August 31, 1962, power to raise or lower all excise, purchase tax (wholesale sales tax) and excise-duty rates by 10 percent (e.g., a 5 percent rate can be raised to 5½ percent), whenever "it appears to the Treasury that it is expedient, with a view to regulating the balance between demand and resources in the United Kingdom," to do so.[1] In the same Finance Act, and for much the same purpose, but also—perhaps incidentally—to induce economy in the use of manpower, Parliament gave the Chancellor power to introduce a tax on payrolls, to a maxi-

[1] See Weekly Hansard, No. 524, 1961, col. 513. Excluded are: Protective and anti-dumping duties, vehicle excise duties, the television license duty, and other excise license duties (except bookmakers' license duty). See Mr. Lloyd, in (Daily) Hansard, vol. 638, No. 90, Apr. 17, 1961, col. 808; and Finance Act, 1961, sec. 9.

mum of 4 shillings per employee per week, payable by all employers who are liable to pay the national insurance employers contribution.[2] The payroll tax cannot be initiated after March 31, 1962, and cannot last beyond August 5, 1962.

The power to raise the indirect taxes has already been employed; in a speech to the House of Commons, July 25, 1961, Chancellor of the Exchequer Selwyn Lloyd announced that as of midnight that night all rates covered by the discretionary power would rise by the full permitted 10 percent, in order to check home demand, in view of the deficit in the balance of payments.[3]

Certain factors make it difficult to draw conclusions for the United States from this British experiment. First, their parliamentary form of government puts the executive on notice that if it abuses the discretionary power too grossly it runs the risk of immediate overthrow; in the United States, we must wait until election day. Second, placing discretion in the hands of the executive is not so much a departure from tradition there as it would be here. In 1940, when the purchase tax was introduced—this is a fairly general sales tax imposed, at varying rate classes, at the wholesale level—the Chancellor was given power, not to change the rates themselves, but to transfer any one or more commodities from one rate class to another, or to exempt any one or more commodities.[4] Moreover, under the British parliamentary system, any time the Chancellor wants to change the rates of an indirect tax he can do so simply by submitting a supplementary budget containing such a measure, which takes effect immediately upon his laying it before Parliament. Parliament must approve, but always does so, unless it wishes to overthrow the Government. Still, the British do recognize that in this year's legislation they have taken what amounts to a new step. The power to shift commodities around within the purchase-tax rate classes has been used on a small scale, and in recent years "only either for dealing with the exempt list of essential drugs and medicines, or for clearing anomalies of classification, whereas the power which the Chancellor seeks in clause 8 of the finance bill is for an entirely different purpose."[5] If the Chancellor wishes to change rates by submitting a supplementary budget, he opens himself to Parliamentary debate, which may be ineffective, but troublesome. The Chancellor himself has explained the need for the new discretionary power on the basis of speed of action;[6] and perhaps more speed is required in a country more exposed to sudden changes in international trade, as is Great Britain.[7]

Third, the Labor Party did not oppose this measure, even though it involved indirect taxes rather than income or profit taxes, and even though its first use would pretty obviously be in an upward direction.

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[2] Mr. Lloyd (Daily). Hansard. vol. 638, No. 90. Apr. 17, 1961, col. 808. The "economy" argument takes second place, in remarks by Lloyd, Weekly Hansard, No. 256, June 13, 1961, col. 252, and Mr. Anthony Barber, Economic Secretary (Treasury), ibid., col. 371, Finance Act, 1961, sec. 30.

[3] "The Economic Situation," text of the Chancellor's speech, British Information Services, New York City.

[4] A. R. Prest, "The Future of Purchase Tax," Institute of Economic Affairs, London, 1961, p. 8.

[5] Mr. Anthony Barber, Economic Secretary (Treasury), Weekly Hansard, No. 524, June 1, 1961, col. 404. In the 15 years from April 1945 to April 1960 "there were 15 finance acts and 61 Treasury orders specifying changes—and many of them multiple changes—in the rates of tax applicable to particular goods," Prest, op. cit., p. 30. During the past 5 years, however, only 16 orders have been issued by the Chancellor for purchase tax changes, 13 of them being for additions to the exempt list of essential drugs and medicines. Barber, Hansard, idem.

[6] Mr. Lloyd, ibid., cols. 559–60.

[7] Cf. Mr. Wilson, ibid., col. 556.

The Labor Party is strongly disposed toward fiscal policy measures in order to avoid what they consider excessive reliance on monetary control.

Fourth, the income tax is not included in this discretionary grant of power; just why, is not altogether clear. The British system of withholding from wages is so refined that a change in rate would be rather more troublesome to institute on short notice than in the United States, but this difficulty does not really seem decisive. To be sure, the British have no estimated-payment provision for income not withheld from, as we do. Still, a powerful impact could be obtained from a change in the income tax in a matter of weeks.

Chairman PATMAN. Thank you, sir.

I suggest that we have the first go-around of about 10 minutes. The chairman will be last. The Chair recognizes the vice chairman, Senator Douglas, first.

Senator DOUGLAS. I think I should defer to those who were here earlier.

Mrs. Griffiths?

Representative GRIFFITHS. I would like to ask you did you say, Mr. Shoup, that the British did not give the Chancellor the power to increase or lower income taxes?

Mr. SHOUP. They did not. The Chancellor did not ask for it and they did not give it. His request was solely to alter the indirect taxes and to impose a new payroll tax, if he needed to do so.

Representative GRIFFITHS. I think you did a very good job of analyzing the effectiveness of it, and I would say that the political system, itself, is more lenient with this sort of a situation than ours would be, as I think you have pointed that out. I would like to return to Professor Buchanan's statement and agree wholeheartedly.

I think that the theory of permitting the President to increase or decrease income taxes has roughly the same political appeal as the suggestion made to the city council that the city planning commission be permitted to locate slaughter houses.

I frankly think that it would not be a good suggestion, and I hope that it does not go into effect. I think we should have a better system than that, and those of us who bear responsibilities for taxes should presume to exercise it.

Thank you very much.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I would be inclined to agree with Mrs. Griffiths' observation on the very persuasive statement by Professor Buchanan.

In order to draw out the panel on it, I would like to ask Bob Nathan, who is certainly a formidable economist and scholar, some questions with respect to the points I thought were raised so well.

In the first place, is it not true, Mr. Nathan, that we do not have the kind of discipline on Government spending that we have on private spending; that is, the only kind of restraint that can be exercised against expenditure of public money, and, of course, there are all kinds of pressures to spend it, is the argument that when you do it you are going to increase taxes and are going to impose a burden almost immediately or very quickly and promptly?

On the other hand, if you argue that you can increase spending and reduce taxes or simply reduce taxes, the discipline that has been imposed traditionally in our democratic system, it seems to me, evaporates, and there is a tremendous temptation on the part of those around you, particularly those who are interested in the political process, to try and persuade the President to go ahead and reduce taxes, particularly as Mr. Buchanan points out so well, say, in September before the election.

Mr. NATHAN. There are a number of points involved in your question. First of all, I do not know that there is less discipline in public expenditures than private.

Obviously public expenditures can vary because of a wide variety of considerations such as the level of taxation, changes in appropriations, public debate on services needed, and so forth. Individual expenditures can bounce around very substantially due to use of accumulated savings, borrowing—wisely or unwisely—confidence in job security, and the like.

As far as political implications are concerned, I am not at all certain that the curtailment in taxation is always so much easier than increases.

Our proposal here, and I think this ought to be emphasized very importantly, is not that tax cuts for stabilization purposes are more desirable per se in terms of the ultimate end purposes. Getting more spending by private people rather than more public expenditures may really be contrary to our well-being as a people and as a nation.

The conclusion of the Commission that the use of taxes for stabilization purposes is better than the use of public expenditure, derives purely from the view that we can get a quicker and larger impact by reduction of taxes than by increasing expenditures.

I think it would be wrong to read into this stabilization argument any conclusion either that the Commission thinks that Government spending is too high or that it is too low relative to our total resources.

Senator PROXMIRE. Let me interrupt right here.

How do you know you can get a quicker response by reducing taxes than by increasing spending?

It seems to me it is exactly the opposite; that that would be the commonsense appeal. If you reduce taxes, you do not know that that tax reduction is going to be spent. It seems to me Professor Shoup or Professor Buchanan, one of them, raised that point.

Mr. NATHAN. Professor Shoup.

Senator PROXMIRE. And I think this makes sense. If you are moving into a recession period and you are trying to overcome it, the government recognizes it by reducing your taxes. This would be a real incentive to save.

On the other hand, if the Government goes ahead and engages in public works or spend money, you know it is going to be spent. You know it is going to have at least an initial direct impact.

Mr. NATHAN. I think you could argue, Senator Proxmire, the exact opposite by saying that if the Government manifests its determination to fight a recession and not let it run its course by a tax cut, and the people know that there will be even more tax cuts if the recession does not reverse itself, I think this, a manifestation of confidence that there is going to be reversal, would result in more consumer spending.

I agree with Dr. Shoup that nobody knows exactly how much of the tax reduction is going to be spent but it is almost certain to be a high proportion of the tax savings.

But you do know that through the withholding technique you do speedily leave more money in the hands of those who are employed.

I, personally would much favor an increase of public expenditures in essential areas than a tax cut. We have tremendous needs for more public services and public investment.

This happens to be my personal view. But how quickly we could get a building program going, is the question. We may initiate an expenditure program which might have perverse effects because the peak of expenditures might not be reached until a year or two after the start of the project.

We seem to have had short recessions, and I think if we take positive actions, we may have even shorter recessions. The more effective our policies are in terms of shortening recessions, the less reliance we can place on public expenditures for stabilization purposes.

Senator PROXMIRE. But is it not true that we had a devastatingly big deficit in 1959, partly, at least, and I think in very large part, because of the automatic——

Mr. NATHAN. That is correct.

Senator PROXMIRE (continuing). Automatic stabilizers. And this worked swiftly and it did have its effect in working us out of the recession of 1959.

On the other hand, you fine people—I think the dominant people in our Government have a view that contradicts the common view expressed by so many erudite economists.

That sophisticated economists view is: That we should in a recession period reduce taxes and increase spending.

But this is precisely the opposite of the dominant view.

We have, for example, the distinguished Secretary of the Treasury, Mr. Dillon, recognized as a practical economic expert with great experience, who said we may have a tax cut if conditions improve enough. He said this some months ago.

Mr. NATHAN. Yes.

Senator PROXMIRE. If conditions improve, revenues increase, and it looks as if we can afford it, and balance the budget. Then says Dillon maybe we will cut taxes. And we certainly have a man of great power and influence in the Congress in the chairman of the Finance Committee who has adopted that viewpoint, and who was appalled at the deficit of 1959, considered it a frightful situation in a recession.

He argued that, if anything, we should not be thinking of spending more, we ought to spend less and we ought to reduce the deficit.

Now, given that attitude on the part of the Secretary of the Treasury, on the part of dominant people in the Congress, it seems to me the most practical action that we can take to cope with this fiscally is to do all we can on automatic stabilizers. Expecting that we can take deliberate action in the kind of political context in which we now exist to further unbalance the budget in recession periods, is a nice dream but I just do not think we can achieve it.

Mr. NATHAN. Actually, it depends on what we want to accomplish. There are still plenty of people, Senator Proxmire, who think it

would have been wise in the spring of 1958 to have had a temporary tax reduction.

We did have substantial recovery, but do not forget that at the peak of prosperity in 1960 we still had fairly substantial unemployment.

We did have an abortive recovery in the sense of full employment. There are many people who feel that, while the recovery did move us from the low levels in roughly April of 1958, to the peak in the spring of 1960 that there was too slow a rate of increase.

There are many people, also, who feel, Senator Proxmire, that the deficit may not have been as great or certainly not greater than the $13 billion, if a purposeful discretionary tax cut had taken place, because then we would have had a more rapid rise in economic activity. As you say, the big deficit occurred primarily because of the deficit resulting from decreased revenues as a result of the drop in income.

Senator PROXMIRE. I would just like to suggest, it seems to me that Mr. Buchanan's observation was so appropriate. Here is a Commission on Money and Credit concerned with monetary policy and their big bold recommendation is in the field of fiscal policy.

Most people accept direct action or at least constructive action in the monetary field. But this fiscal field has plenty of controversy and there are all kinds of objection and it is a terrifically difficult path to follow.

If you concentrate on the kind of action you have been advocating in monetary policy to keep interests rates as low as possible and to make borrowing as easy as possible, this is far more promising. There is a great deal of sentiment in Congress in favor of having a more constructive monetary policy to expand the economy and push it along.

But this seems to have been neglected by the appeal for looking over in the other area and finding that to be a little more spectacular.

Mr. NATHAN. I would just say two things, Senator Proxmire.

First. I think you cannot expect monetary policy to do the whole job. If you neglect fiscal policy, which is a very important instrument, you will need extreme monetary measures that can do much harm. I could not disagree more with Professor Buchanan about automating everything, which is, I think, the implication of what he said.

I cannot understand how we really automate policy changes when, as Dr. Buchanan says, we do not know how the economy functions.

I am for more automatic changes—for more responsiveness—but I do not think we can or should neglect discretion in the fiscal area. Otherwise, the monetary area will be saddled with almost impossible burdens.

I want to respond to Professor Buchanan's statement about the failure of the Commission to look at automaticity or automation in the monetary area and having looked at it only in the fiscal field.

We must not forget that in the monetary area we are dealing with an entity, the Federal Reserve Board, an entity which has some element of independence, an entity which is not in daily association with other branches of Government.

In the fiscal policy we are dealing with the Congress, with the Executive, with a wide variety of agencies and groups.

In the monetary area we have, in a sense, a single authority. I have not always agreed with what the "Fed" has done, but, nonetheless, I have very serious doubts of trying to arrive at a rigid formula for monetary action. We do not know as much as we would like to know about the economy, which hardly warrants turning increasingly to automatic devices. We would be running away from responsibility.

Nor do I think that we should run away from discretion, either, because we are afraid of politics.

Senator PROXMIRE. My time is up. I will come back with questions later.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Nathan, you seem to have gone along with the great doubts expressed by the Commission on the effectiveness of discretionary expenditure policy for countercyclical purposes.

Mr. NATHAN. Historically, yes.

You mean as to how effective it can be?

Representative REUSS. Yes.

The Commission gives it a very secondary role as opposed to discretionary tax policy.

Mr. NATHAN. I do not think it ought to be given a secondary role, by any means, but I do recognize in terms of speed and short-run stabilization that it has a secondary role relative to tax policy.

Representative REUSS. I would like to pursue this a bit with you, and I will refer to your restatement of the Commission's reasons.

You say:

> Many Government expenditures cannot be accelerated or curtailed speedily, especially if a criteria of efficiency and usefulness is strictly applied.

That is, of course, true, but is it not equally true that many can?

Mr. NATHAN. Oh, yes.

I think at one place in the Commission's report it is stated as much as a billion dollar increase in expenditures could be quickly achieved. I think that probably understates the magnitude of what could be accomplished relatively quickly.

I certainly believe that we ought to build up our shelf of public works, our project planning, our longer range capital programing, incentives to State and local governments and to maximize the role of public expenditures for stabilization purposes.

Representative REUSS. I did not find much evident awareness in the Commission's report of the differences between long-term, large-scale public works projects of the sort that we traditionally associate with the Federal Government, for example, a Grand Coulee Dam, and short-term, easily completable, run-of-the-mill public works projects that we conventionally associate with local government, for example, a neighborhood library, a new firehouse, a regional police station, repaving a street, and so forth, and so forth.

There are now, unless I am misinformed, some $20 billion worth of that kind of project on the books of local communities, large and small, all over the country, which could be started within 30 days and finished within 1 year.

Mr. NATHAN. $20 billion?

Representative REUSS. $20 billion, according to a study made by General Bragdon, who was President Eisenhower's last Public Works Coordinator.

If that is so, or if that is not too wide of mark, is there not a rather fertile possibility of using Federal matching grants to help localities get on with the job?

Mr. NATHAN. There is no question, if the magnitude is of that size. If $20 billion could be started within a month and completed within a year then, there is a serious understatement by the Commission of the potentials in terms of expenditures for stabilization purposes.

Representative REUSS. I note that you say, and the Commission says, that:

> Efforts should be made to provide incentives for State and local governments to modify their public expenditure programs in a countercyclical direction.

I have already suggested how you do that. If you are on the downswing and want to come up, you give Federal matching grants.

How, however, do you give incentives to State and local governments to relax? Just an admonition to go easy?

Mr. NATHAN. I think the main one actually, Congressman Reuss, would be in taking away the grants. For instance, in the summer of 1958, the Federal Government might have said to State and local governments that for added expenditures in essential categories, such as firehouses, schoolhouses, or streets, we will match 20 cents for every 80 cents you spend within the next 12 months. If later it looked like we did not quite need as much stimulation, we might have matched 10 cents with 90 cents in the next 6 months, and then as the need ended, there could have been no matching at all. If this became a pattern, I think the lack of matching funds would be quite a deterrent because they would figure that if they held off a little while, they may get that 20 cents again.

In other words, I do not conceive of a reasonable penalty which would be symmetrical with the matching grant.

Representative REUSS. So withdrawing the antideflationary stimulus would, in your opinion, be the sovereign remedy?

Mr. NATHAN. That and, of course, higher interest rates which would be an element in discouraging the flotation of local government securities at a later period of intense activity.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Douglas?

Senator DOUGLAS. Mr. Buchanan, I rather infer from your paper that you place very little reliance or gave little support to the idea that fiscal policy should be used for stabilizing purposes, and that you would throw almost your entire emphasis on monetary policy, am I correct in that?

Mr. BUCHANAN. Yes and no, sir.

I think, if you start with the assumption that we are going to do nothing basically about monetary institutions, I would support using a fiscal policy to supplement monetary policy. I think that it would be possible to remove the necessity of using fiscal policy if, in fact, we could undertake the basic structural reforms in our monetary institutions that seem to be required.

Senator DOUGLAS. Let me ask this.

It is undoubtedly true that by raising interest rates and tightening the supply of bank credit, we can restrain what the monetary authorities may regard as undue expansion, but I have never thought that in a period of depression, as distinguished from recession, that lowering interest rates and creating more monetary purchasing power necessarily would bring a revival of business activity, because the credit must not only be available, but it must be borrowed.

And the characteristic, of course, of the great depression was that a business did not want to borrow, and that, therefore, it seems to me that in dealing with a severe recession or depression, that monetary policy is very inadequate.

On the other hand, I think it is true that fiscal policy will not be used to restrain an undue boom because no one likes to impose higher taxes, but it can be used to check a recession and prevent it from becoming too severe. That raises the question whether we should not have a two-platoon system, so to speak.

Use fiscal policy in a period of recession and use monetary policy in a period of undue advance.

Send the bankers in when things are getting too expansive; send the politicians in when things are going the other way.

Mr. BUCHANAN. I think there is a great deal in what you say, Senator Douglas. I think there is a basic asymmetry here. I would only make one comment.

I think it is a little too easy perhaps for us to associate monetary policy with what happens to the interest rate. In the great depression it is true that we had easy money in the sense of low-interest rates, but we did have at the same time a monetary policy which was contractionary.

The money supply actually was going down during this period, and I wonder if things would not have been different——

Senator DOUGLAS. How about using open market operations by the New York bank at the same time?

The simple fact is that business did not want to borrow, did not want to expand.

Let me ask you this question:

Assuming it could be wisely done, would you favor the creation of a deficit during the period of recession?

Mr. BUCHANAN. Again, my answer would be a qualified answer. I think deliberate creation of deficit for stabilization purposes—over and above the automatic stabilizers—is perhaps not wise policy for what might be called a recessionary period.

Certainly, and I think all economists would agree, in major depressions, if they should occur again, we should do everything possible; create deficits or whatever.

Senator DOUGLAS. To create deficits?

Mr. BUCHANAN. Yes.

Senator DOUGLAS. For a depression, but not for a mild recession?

Mr. BUCHANAN. Yes.

Senator DOUGLAS. Mr. Nathan, how do you feel?

Mr. NATHAN. I would not agree.

It depends on our objectives. I think, if our objectives are to ride through a mild recession, whether it takes 12 months or 18 months longer, it would be costly and wasteful. Automatic fiscal stabilizers do bring deficits which help cushion declines but that is not enough.

I would much prefer to see, even in the short recessions, the pursuit of temporary antideflation fiscal policies which would seek to bring the turn-around quicker and reach the peak more rapidly.

Senator DOUGLAS. Professor Shoup?

Mr. SHOUP. Yes, I feel fairly strongly, Senator Douglas, that action should be taken in lowering tax rates even in fairly mild recessions.

There are two points, perhaps I might make, in that connection that have not come up yet.

One is that the revenue decrease we get automatically from built-in flexibility seems to come very largely from the corporate income tax.

Senator DOUGLAS. That is right.

Mr. SHOUP. And that, in turn, does not seem to do very much for stimulating spending right away. It is too far removed from the immediate consumer, and it does not, I think, have as powerful an impact as the reduction in taxes on consumers, such as the income——

Senator DOUGLAS. Would you favor reduction in the excise or income tax?

Mr. SHOUP. Income tax.

After all, in our Federal revenue system anyway, it is the income tax that is the powerful instrument.

Secondly, perhaps I am too optimistic, but, as my statement indicated, I am not too worried about so-called political misuse of discretionary power.

It is very revealing, I think, if we go back over the history of the past 40 or 50 years, and make a tabulation of the years in which the heaviest tax increases occurred, we find that most of them were election years.

Actually, there seems to be no correlation historically between elections and tax decreases; in fact, oddly enough, it has been almost the other way around.

Senator PROXMIRE. Will the Senator yield for just a minute?

Senator DOUGLAS. Of course.

Senator PROXMIRE. Have you actually made this study, and if so, I would be very much interested in it.

Mr. SHOUP. I have made an informal study of it from my work with students at Columbia. Yes, I will be glad to make it available. It refers chiefly to the 1930's.

Chairman PATMAN. Will you expand your remarks in connection with correcting the transcript?

Mr. SHOUP. Yes, I will.

(The following was later received for the record:)

MAJOR REVENUE ACTS, 1913-58, CLASSIFIED AS PREDOMINANTLY TAX INCREASING OR PREDOMINANTLY TAX DECREASING

Carl S. Shoup

Tax increasing:	Tax decreasing:
1913	1921
1916[1]	1924[1]
1917	1926[2]
1918[2]	1928[1]
1932[1]	1938[2]
1933 (NIRA)	1939
1934[2]	1945
1935	1948[1]
1936[1]	1954[2]
1937	1958[2] (technical amendments and small business)
1940[1]	
1940[1] (second act)	
1941	
1942[2]	
1943	
1944[1] (individual income tax)	
1950[2]	
1950[2] (excess profits)	
1951	

[1] Presidential election year.
[2] Congressional election year.

Source: Classified from information on revenue acts in "History of the Federal Revenue Acts," Federal Tax Course, Prentice-Hall, 1960, pp. 5582-5587.

Senator DOUGLAS. The difference among these three gentlemen seems to be as to when one should reduce taxes.

Mr. Buchanan would only do this if we had a severe depression.

Mr. Shoup and Mr. Nathan would do it if we had a recession.

Then the question comes, what is the definition of a "depression" and what is the definition of a "recession"?

What would you do, Mr. Buchanan, to help the President, Members of Congress, or if you are going to devise a formula through some Univac machine, what would you feed into it? What index of unemployment would you consider? What movement of the price level? What degree of unused capacity of plant and equipment?

Mr. BUCHANAN. I would not use an index of employment at all.

Senator DOUGLAS. Of unemployment.

Mr. BUCHANAN. Of unemployment at all.

Senator DOUGLAS. You would not. You would disregard that. If unemployment were 10 percent and prices rising?

Mr. BUCHANAN. I think that is placing a responsibility on the whole monetary-fiscal stabilization set of instruments that is not proper to place there.

Senator DOUGLAS. In other words, the monetary and fiscal should not consider unemployment, no matter how high it is, they should pay no attention to it. You will be on the Federal Reserve Board before you know it.

Mr. BUCHANAN. My position is, as follows: That the appropriate criterion for stabilization action should be some index of prices or of incomes.

Senator DOUGLAS. Purely a financial test?

Mr. BUCHANAN. And that if unemployment prevails, serious unemployment in that situation, we should take action, but we should take action in freeing up factor and product markets.

Senator DOUGLAS. Mr. Nathan and Professor Shoup?

Mr. NATHAN. I would consider many measures. The income index, in a sense, is the reverse of unemployment. The measure of gross national product or national income would, in a sense, be reflecting employment. I certainly would look at all major economic series.

If we use only the price series—and I think price series ought to be one of the elements taken into account—the implication was in the very last words of what Professor Buchanan said; namely, that factor costs offer the keys to fighting inflation, would fail to help us find real solutions.

The Commission on Money and Credit dealt at some length, and I think quite revealingly, with different kinds of inflation. The questions of demands—of factor costs, of monopoly and market power—and the roles they play were discussed and studied at length.

The Commission came to the conclusion that if we did tend to have a persistent element of inflation in the economy which derived from other than excess demand, then one must not seek to fight this inflation exclusively through aggregate monetary or fiscal approaches but that there are the other elements of labor mobility, of retraining, of antirecession activities, of helping in the shift of resource application, and the like which must be attached directly and selectively.

I think one cannot look at the price series per se and automatically say that if prices go up 2 percent in a year, this necessarily means that we have to exercise restraint on aggregate demand.

Representative WIDNALL. Mr. Nathan, you said the Government deficits can stimulate consumption and thereby encourage capital formation.

I notice you use the word "can."

How can you differentiate between the word "can" and "will" at that point?

Mr. NATHAN. It depends, of course, on the level of activity. If you have a Government deficit at high levels of economic activity, and a limited supply of idle capacity, the deficit may increase consumer capabilities, but it will not increase actual amounts of purchases and consumption, because no more output will be available.

The impact depends also on the kind of tax cut. If the tax is cut primarily at those levels which leave money in the hands of low income consumers rather than high income recipients, it clearly would tend to bring a maximum increase in consumer capacity to purchase. With idle capacity, increased purchases tend to stimulate more investment in inventories and in productive capacity. When we have an inadequate investment demand relative to savings, we can stimulate investment demand by stimulating consumer demand.

Representative WIDNALL. Are you not saying, in other words, that a Government deficit willfully created can have a more beneficial effect on the economy than one that occurs because of a drop in revenue?

Mr. NATHAN. There is no question but that you are absolutely right, sir.

One will be a positive and more rapid effect in terms of cushioning the decline and stimulating a rise in business activity.

We should not wait for derivative consequences of bad business to bring improvement, we should seek to prevent the adverse circumstances. If we don't prevent them we should act boldly and promptly to reverse adverse trends and bring rapid recovery.

The automatic stabilizers, like unemployment compensation, are very valuable but we should also take aggressive positive measures as well as benefiting from the automatic stabilizers.

Representative WIDNALL. As a means of meeting the unemployment that exists, do you not feel that probably the most important thing is the retraining of workers?

Mr. NATHAN. With respect to many of our distressed area problems, this approach is very useful. The element of labor mobility is a highly important one. On the other hand, there is a serious question, Congressman Widnall, in the minds of many people, whether our consumption, savings, investment, tax pattern is one which is conducive to full employment, even if we had the highest degree of mobility in our labor force. They question whether the present fiscal arrangement is such that at full employment we would not have such a large Government surplus that we will not have the investment demand to absorb that level of private savings on a sustained full employment basis.

Representative WIDNALL. How do you feel about that, Professor Shoup?

Mr. SHOUP. With respect to the present system in relation to full employment and savings and so on, yes, I think there may be some indication that the present tax system is geared a little bit too high to allow full recovery from moderate recessions. It is an extremely difficult question to answer, though, and I think it would need a great deal more study.

I am more concerned myself, though, over certain aspects of the structure of the tax system. I think, for example, some of the tax rates on investment, especially the corporation tax rate, have probably reached too high a level, and have been choking off somewhat certain capital investment projects that might otherwise take place, so that it may be partly a matter of the structure of the system we now have, partly a matter of the heaviness of it.

But, obviously, something is standing in the way of full and complete and quick recovery.

We need to find out what that is.

Incidentally, may I add I would feel much more sure of my ground if I knew more about what the unemployment figures mean. I would hope that in the future we would be able to get the figures on unemployment broken down by types of unemployment, the reasons for the unemployment, and so on, much more than they are now, so that we would not be depending too much on some simple global figure.

Representative WIDNALL. Would you not add to that the very important factor as to the impact of imports on unemployment in the United States.

Mr. SHOUP. No, I do not think that the imports are a cause of our failure to recover fully. After all, we are, among other things, a trading nation, and we must import, if we are to export.

Representative WIDNALL. Of course, that is causing some of the hard-core places of unemployment in the United States.

Mr. SHOUP. If, indeed, there are certain areas in which we now have a comparative disadvantage and can import more cheaply than we can produce, the answer surely will lie in retraining of workers and movement to other industries rather than depriving ourselves of the possibility of getting these goods more cheaply from abroad.

Representative WIDNALL. Professor Buchanan, would you have any thoughts on that?

Mr. BUCHANAN. This last particular point?

Representative WIDNALL. Yes.

Mr. BUCHANAN. No.

I think I would associate myself largely with what Professor Shoup said on that point.

As far as the general point about whether or not the current tax structure is too high to generate full recovery, it is something on which I simply have not studied sufficiently to make an informed judgment.

I do think that we should be careful lest we slip into the very easy position to assume; that is, it gives us another excuse to cut taxes. That is always the easy position to take.

Representative WIDNALL. Professor, you make a very effective presentation as to the direction of the Commission in studying fiscal policy almost to the exclusion of monetary policy.

Are you prepared at this time to make any constructive suggestions that you might have with respect to monetary policy?

Mr. BUCHANAN. That opens up a great deal of area. I might just say this, and it goes back to a comment made by Mr. Nathan a few minutes ago about the Federal Reserve being an independent entity, and then went ahead and undertook its task.

I would have preferred to see the Commission examine the whole issue of the structure and operation of the Federal Reserve System.

I do not think the Commission should, in fact, have sort of assumed this as an independent entity at the outset. I think they should have examined the whole monetary structure.

Now, there are many proposals that have been made. There is one associated with the name of Professor Friedman, of the University of Chicago, in which he says that the rule that we should adopt for monetary policy is simply increase the money supply 4 percent a year, roughly the increase in the gross national product, and that is it.

I think this proposal is deserving of a great deal of consideration. I should have liked to have seen the Commission consider it.

I am not prepared to say that I would support that rule over any other particular rule or any other structural reform. I do think that this is an area in which some quasiautomatic rule is needed, one which would involve basic structural changes, which would remove administrative authority from the Federal Reserve System, so that people in their own private behavior could know in advance what is going to be done.

I think it is an area in which many rules are better than no rule, and it is the choice among these rules which is a relatively complicated problem.

Representative WIDNALL. Mr. Nathan, I just wanted to ask you one question.

You are a member of the Commission, and, as evidently the Commission did concentrate on fiscal policy far more than monetary

policy, was there a policy developed at the first meeting of the Commission to do this?

Mr. NATHAN. First of all, Congressman Widnall, I disagree with that conclusion. In my judgment, the Commission spent far more time on monetary policy than fiscal policy, far more.

We had Milton Friedman at sessions. We talked over this matter of the formula, of the fixed increases in money supply.

We had some of the top monetary people—Shaw, Gurley, come in as advisers or consultants. There were six task forces set up initially and then a seventh one by the Commission, and only one was concerned wholly with fiscal policy.

And actually, as I pointed out in my statement, Congressman Widnall, chapter 5 is entirely related to fiscal policy. Then there is a little bit more on fiscal policy in chapter 2 on goals and chapter 9 on policy.

But most of the report deals with the monetary and credit areas, rather than the fiscal.

It may well be that Professor Buchanan is right, that we did not come up with enough brand-new ideas. I did not mean to imply before that we give the "Fed" a good-performance medal and that we should not question its record or we must not touch it. Quite the contrary.

Many people feel we have dealt with the Federal Reserve too roughly in many ways. But, my judgment, Congressman Widnall, is that we should have spent even more time on the fiscal area than was given to it. I was somewhat unhappy with the limited amount of emphasis on the fiscal area.

A great proportion of the Commission's time was spent, Congressman, on the monetary side.

Representative WIDNALL. I want to thank you.

Chairman PATMAN. I just want to bring out one point. The House is considering a very important bill today, as well as the Senate, and I want to get back to the floor pretty soon, and I want to ask Senator Douglas to preside, if he will, and take as much time as he desires.

I want to mention about what Mr. Buchanan brought out, and I will quote his testimony:

> Could the same results be accomplished more effectively by changes in the monetary constitution? Given the absence of any specific directive or rule for the operation of the monetary authority, it is little wonder that we have had fluctuations in the economic system. Without some built-in predictability in the monetary system, such fluctuations must continue. The Commission, in my opinion, has passed over an excellent opportunity to examine the basic structure of the monetary system.

I agree wholeheartedly with you, Mr. Buchanan. I cannot understand why that Commission skipped over so many important things. They skipped over even the fact that the number of banks have been reduced in the last 40 years during the greatest growth in our history.

Forty years ago we had 31,000 commercial banks. Today we have 13,560.

The Commission did not even touch that, did not go into it at all, did not go into the question of the local commercial banks failing to perform their duties, to take care of their people in the areas where they are chartered to do business. But, on the other hand, go into the long-term Government bond market, and are even manufacturing

money for the purpose of buying not only long-term bonds, but tax-exempt bonds. And they own about 30 percent of all tax-exempt bonds. Now, the Commission did not touch that.

I am disappointed that they recognized the Federal Reserve as a separate or independent entity, when the proof is clear and undisputed by the people in the United States who know, who are supposed to know, that the Federal Reserve System is a Government institution.

The banks do not own the Federal Reserve System. The stock that they are supposed to own is not stock at all. It is a misnomer. They cannot hypothecate it; they cannot sell it; they cannot use it.

They only get 6 percent; that is the only obligation of the stock.

So it is not a system that is owned by the private banks. It is owned by the Government. Therefore, I cannot understand why they would recognize it as a separate entity. I shall not go into that because I do not have the time. But I would like to ask Mr. Buchanan this question:

What is his suggestion, what is your suggestion, Mr. Buchanan, as to what the Congress should consider doing about giving the Federal Reserve better guidance?

I feel that we are lacking there. You take in 1913, there were certain directives, mild reform, not very positive, and very indirect, and they have never been given guidance since. In fact, the Federal Reserve does not even have the power under the law to direct monetary policy or to consider monetary policy. That is not in the act.

They are just doing it.

And, of course, when the Employment Act of 1946 came along, they said: "That is it; it directs us to do it."

But the Employment Act says in coordination with other agencies, which they ignore.

So what would you recommend in that case, Mr. Buchanan?

Mr. BUCHANAN. Mr. Chairman, I am very glad that you raise that question about the directive to the authority, because I think I would like to make some comment.

First of all, the Commission does propose in the last chapter that directives be given to the authorities, whether they be administrative auothorities or the Federal Reserve Board; the directive that they propose is that they should look to a reasonably low level of unemployment, a reasonably stable price level, and a reasonably adequate rate of growth.

I would say that they might as well have said "be good." I would say those objectives are completely and uttterly meaningless. In this connection, I would like to see the various objectives thrown out and discussed—and I believe this is something on which perhaps Mr. Nathan and I can agree.

Now, Mr. Nathan might propose that we put a specific employment index in front of the Federal Reserve Board, as Senator Douglas might propose.

I might propose that we put a price or income index. But I should like to see the Congress and those who are interested in this problem openly discuss specific criteria, in terms of an unemployment of 3 percent, 4 percent, or in terms of a stabilization of the wholesale price index or some consumer price index, or an increase in the quantity of money, or something of that nature, something that you could put your hands on.

We will disagree, but let us debate it and discuss it; not these vague generalizations about objectives which conflict with each other; reasonably adequate growth, reasonable stability in the price level, and a reasonably low level of unemployment.

Chairman PATMAN. That is the reason you suggested that:

> The Commission, in my opinion, has passed over an excellent opportunity to examine the basic structure of the monetary system.

Mr. BUCHANAN. Yes, sir.

Chairman PATMAN. Senator Douglas, will you preside, sir? I think Mr. Curtis is the only one who has not asked questions.

Senator DOUGLAS. (now presiding). Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I just came in. I would like to say this for the record. The reason for my poor attendance at these hearings is that the Ways and Means Committee is in executive session on various proposals on tax legislation. I have not had a chance to read the panel statements; I want to apologize to the panel for my inability to attend and hear their presentation.

I have been running over, very quickly, this statement of Mr. Buchanan's. I certainly must say that there are a lot of notions I share with him and I am very happy about that.

Senator DOUGLAS. Senator Proxmire?

Senator PROXMIRE. Mr. Buchanan, I am not sure that you came through to me when you were discussing with Senator Douglas your position on the importance or lack of importance of unemployment.

You do not mean to take the position that the failure of the economy to fully utilize this crucial part of our productive resources, manpower, should not be considered as a criteria in determining monetary and fiscal policy?

Mr. BUCHANAN. I think we would all agree that this is an extremely important policy problem, and it is certainly a criterion for Government action to do something to eliminate this unemployment and to get our economy operating at full scale.

My question is really whether or not this is an appropriate, instrumental criterion for monetary-fiscal policy.

As I stated to Senator Douglas, insofar as we make the assumption that we are not going to change basically our monetary structure, then I think a very good case can be made for utilization of fiscal policy.

Senator PROXMIRE. Let us stay just for a minute with monetary policy.

On page 38 in the report, for example, there is a discussion of the impact of demand on prices. It is pointed out that, wherever you have 8-percent unemployment, that demand can be increased without any significant increase in the price level.

But, where you get down to unemployment of 4 percent or 2 percent, the increase in the price level is likely to be fairly direct and immediate.

Now, why is this not a sensible consideration? What is the matter with that kind of analysis?

Mr. BUCHANAN. I certainly accept that basic analysis. But, you see, if those facts are true, by using the price index or some price index as an instrumental criterion, and operate your monetary authority on

the basis of that criterion, you would, in fact, secure unemployment to the lower level you mentioned: 3 or 4 percent.

Senator PROXMIRE. So, if you had a situation in which the price level, for reasons that are still hard to ascertain, might be rising, as it was, as I recall, in 1959, and unemployment is high, recession deepening, you would feel that you had to pay more attention to the price level, and you would follow a contracting monetary policy?

Mr. BUCHANAN. No, I would not.

I think on the basis of the 1959 experience—well, there are several things I would say.

On the basis of the 1959 experience, there is evidence that the Federal Reserve Board, in fact, did not allow the money supply to expand as they should have allowed it to expand.

Senator PROXMIRE. I agree.

But one of the reasons I feel so strongly about it is that we have unutilized resources and, by letting the money supply expand, you increase demand and under present circumstances you do not place a significant pressure on prices.

There are other reasons for prices going up, structural reasons, that are not related to demand so much. Therefore, I think that the kind of monetary policy you follow should be very much concerned with unemployment; certainly not the only criterion, but it seems to me it is one of the very most important.

Mr. BUCHANAN. I do not think, really, we disagree a great deal.

Certainly we agree that unemployment is very important. My real question is whether we look at the employment index as an instrumental criterion for guiding our monetary-fiscal policy, or whether we look at another index.

And if we look at another index, say, a price index, and then look at the unemployment, we would always want to look at the unemployment.

But then that enables us to separate out, so to speak, these two problems that Mr. Nathan alluded to, those basic structural market factors which are creating the unemployment, or the decline in aggregate demand.

My whole point is simply this:

That the appropriate function for monetary-fiscal measures, whatever mix we might agree on, is to maintain aggregate demand. I think that if we look beyond the maintenance of aggregate demand into an employment index, then we are mixing up two things.

Senator PROXMIRE. These two things are so closely related. It seems to me that you can get a much clearer picture of the adequacy of demand by considering employment than you can with the price level.

With administered prices, with any number of interferences, because of our trade-union structure and so forth with the price level, we know, if we have 8 percent of the work force out of work, if we have, as Senator Douglas suggested, 20 percent of our factory capacity idle, we know that at least in a very important sense demand is inadequate, regardless of what price statistics may show about what has happened to the level of prices. As far as demand is concerned, it is not adequate to come close to utilizing our resources, is that not correct?

Mr. BUCHANAN. I think I would disagree on that.

I think we would know under that situation that something is wrong with the functioning of our product and factor markets, and this is where I think we ought to look to this structural unemployment problem.

Senator PROXMIRE. What is wrong? You mean monopolistic situations? We should undertake antitrust actions which would take many years?

Mr. BUCHANAN. That is one possibility.

We mentioned the retraining of labor that is thrown into unemployment by technological change, shifting of labor out of depressed areas, and so forth and so on.

Senator PROXMIRE. I have some more questions. I would like to yield to Mr. Curtis. I understand that he has a rollcall he has to get to, and I will be happy to yield at this time.

Go right ahead and I will come back.

Representative CURTIS. Senator, you are very kind. I did have a couple of general questions, if I may.

One thing I have not had a chance to review with Mr. Shoup but to which I would like to direct his attention, Mr. Nathan refers to this Government surplus.

I note in the discussion of fiscal policy, neither in the money and credit report of the Commission, nor in the paper, is there much attention directed to the position of the debt, whether or not we should have a debt; and if we should have a debt, do we relate it to percentage of gross national product, or what.

I wonder if all three would comment briefly on that aspect of fiscal policy.

Mr. NATHAN. I would like to say just one or two words about that subject.

The Commission did discuss at considerable length the matter of debt, and concluded—I think it is implied in the report—that a lower debt might be more desirable than a higher debt.

Representative CURTIS. Lower percentagewise, Mr. Nathan, or absolutely?

Mr. NATHAN. I think just lower. But it indicated that debt changes; whether the debt be reduced, maintained, or expanded, absolute or relatively, ought to be determined primarily by the fiscal policy that is needed for sustained high levels of activity, price stability, and vigorous growth.

While the commission never really got down to the precise question whether if it came to a point that our only choice was between a rising debt or unemployment, I think the implication of the report is that we would choose the increase in debt.

Debt is not, in and of itself, a desirable objective, but it is a derivative of what our fiscal policy is, which has a primary impact, along with monetary and credit policy on full employment, vigorous growth, and price changes.

Representative CURTIS. And, of course, then your Government surpluses would obviously only be yearly propositions, whatever the debt might be. Of course, the surplus is not a real surplus as long as we have an underlying debt in the total sense.

Mr. NATHAN. It can be a current year's surplus.

Representative CURTIS. Yes.

Mr. NATHAN. It may not be an accumulated surplus, cumulative, but it would be a surplus in the current year in which it occurs.

Representative CURTIS. Yes.

I wonder if you would comment, Mr. Buchanan.

Mr. BUCHANAN. I would like to make one comment. Perhaps I have seemed overly critical of the Commission's recommendations.

In general, I would like to support the Commission strongly in one aspect of this. I do think that if you decide to utilize the fiscal system to stimulate economic growth, perhaps the most effective way of doing this would be to create a surplus and use the surplus to retire the public debt.

The Commission makes this recommendation, and on this point, I am in accord with the Commission.

Representative CURTIS. There are two things about the debt. Many people like to relate it, and certainly it is a meaningful thing, as a percentage of gross national product.

I have often thought that not only should that be a factor, but we also ought to be thinking of its absolute amount from the standpoint of the marketing of that debt, the selling of bonds and so forth, because it has quite an impact on other investments, and so on.

So, when they say, apply the surplus, that would be when the debt is X percent of the national product, or what criteria should we apply?

And is there a top to an aggregate figure? Can the debt become so large just absolutely even though it is a smaller percentage of gross national product without the mere handling, the management of it creating a difficult problem?

Mr. BUCHANAN. You want me to comment?

Representative CURTIS. I thought if you wanted to comment. I did want to get Mr. Shoup's comment, and then I will have to run.

Mr. BUCHANAN. I do think there are basic questions in the comments you make. I am not sure that I would respond specifically to them.

I do not think there is a great deal of merit in relating the debt to the gross national product per se. I think the absolute magnitude of the debt, as you suggest, is perhaps equally or perhaps more important.

As far as the detailed impact on the financial markets, I think these are questions that the Commission did explore, to some extent. I am not too familiar with that particular problem at this time.

Representative CURTIS. I guess this was not on your agenda, although I was a little surprised, because fiscal policy would have to be related to the debt, in my judgment, in order to be a meaningful discussion.

Would you comment?

Mr. SHOUP. First, let me say, Mr. Curtis, that I think of the public debt in terms of the net public debt, that part of the Federal debt that is held outside of the Federal Government.

In other words, a substantial part of the Federal debt is owned by the Federal Government itself, and it is only the balance, it seems to me, that is important.

In those terms we find there has been little growth in the public debt since the end of the war. Accordingly——

Representative CURTIS. In other words, for instance, your social security fund.

Mr. SHOUP. That is right, and other funds have absorbed substantial parts of the debt.

And, although the public debt in its size must be related to something, if we are to judge its significance, I, too, would agree that no mere rule-of-thumb comparison with gross national product is of any use. Perhaps all we can do is empirically observe what is happening, and if any of our troubles seem to be due to something called too large a public debt, then try to retire the public debt.

But I, myself, am unable to see that any of our current troubles are due substantially to the existence of the size of the public debt that we now have.

To be sure, a public debt this large can be mismanaged, and if it is mismanaged, it can cause a lot of trouble, but that is not to say that we have to retire it.

Representative CURTIS. Mismanagement can have very grave implications in the monetary policy.

Mr. SHOUP. Quite so, but I would not conceive of that as being a sufficient reason for levying heavy taxes to get rid of the public debt. I would rather see us manage it correctly, sir.

Representative CURTIS. Thank you, Senator Proxmire.

Senator PROXMIRE. I would like to ask Professor Shoup a few quick questions. I wonder how germane this British experience is.

It is very interesting and it is good to have a concrete comparison and analogy.

In the first place, it is true, is it not, that at the present time the British are extremely concerned with their adverse balance of payments?

Mr. SHOUP. That is right.

Senator PROXMIRE. And that they are in a far different position than we are. They are far more sensitive to international trade?

Mr. SHOUP. Yes.

Senator PROXMIRE. Much more dependent on it. So they can take this decisive action of increasing their taxes without the kind of repercussions that the President of the United States perhaps could take. At least the people are more aware of the necessity because it is a greater necessity, is that correct?

Mr. SHOUP. Yes.

I think the people are perhaps more aware of the need for rapid change. There is a bit of a paradox there, though. The very parliamentary system they have seems to make it possible for them to make rapid changes without any undue delegation of discretionary power, and yet, they seem to feel the need for speedy action, extremely speedy action, so intensely that now they have gone beyond what the parliamentary system ordinarily does and have put discretion in the hands of the Chancellor to act without even calling Parliament into session.

Senator PROXMIRE. How substantial a change really is this? This is a change of, say, what was it, from 5 to 5½ percent?

Mr. SHOUP. 10 percent in the rate, so that a 10-percent rate might go up to 11 or down to 9 percent.

Senator PROXMIRE. Would this be comparable to any change in the excise tax we might make or do we not have comparable excises?

Mr. SHOUP. In the range of comparable excises they have, ours are much lighter and fewer in amount. Our cigarette tax, which if I recall correctly, is 8 cents a package, would be put up or down a cent or so. It is not a great deal. What is more significant is that it is a real departure from their traditions, even in view of what they did with the purchase tax, which was not much, on discretionary action.

And the debates in Parliament this summer clearly indicate that they realize that they are taking a decisive step in giving the Chancellor such power.

Senator PROXMIRE. Even in England, where they do face this tremendous problem because of the Common Market situation, because of their booming economy at the same time that they have an adverse balance of payments, even there, there has been no apparent action, maybe no consideration given to giving the same discretion on the income tax, which is what the Commission here recommends?

Mr. SHOUP. Certainly, they have not given discretionary action on income tax. But my reading of the debates is that this is more because there were thought to be certain administrative problems involved in changing the pay-as-you-go or withholding system quickly, rather than any general decision that somehow income taxes would not be good taxes to change.

In fact, the Labor Members of Parliament brought up this matter of income tax directly and asked why they had not put that into the proposal, and the answer seemed to be coupled with these assumed administrative difficulties.

Senator PROXMIRE. When you said earlier you felt there would be no greater degree of error if you had a congressional or Presidential tax cut to meet a recession problem, if you had it automatic, did you take fully into account the fact that a very large proportion, and I think perhaps more than half of the Members of the Congress, and many of the President's closest advisors, including the Secretary of the Treasury, feel that we should reduce taxes when revenues increase and when we can do so without unbalancing the budget?

Obviously, if you have that kind of concept on the part of many Members of Congress, any notion that you can have the kind of deliberate fiscal policy that can stabilize the economy just goes right out the window, because the idea in the minds of almost a dominant, and I think a dominant, number of the Members of Congress is that you should adopt a completely contrary policy.

That the responsibility of the Congress is to balance the budget as soon as they can; that it is easier to balance the budget, obviously, in periods of prosperity, and in those periods that you can justify a tax cut because the budget is balanced, and this is the kind of prudent management that meets prevailing political convictions.

Mr. SHOUP. I suppose my answer would be that I am not willing to settle, so to speak, with the view that this must be the kind of attitude that we will always have to deal with over the next 5, 10, or 20 years.

After all, we have made great strides over the past 20 or 30 years. In 1932, the biggest single increase in income taxes that had ever been enacted was enacted, and by an overwhelming majority, in Congress.

Senator PROXMIRE. It was a fantastic time to do it, 1932.

Mr. SHOUP. That is right, for reasons that we now all recognize, I think, were clearly wrong. So we have made great progress.

We will never do that again.

Senator PROXMIRE. This is a point you and I disagree on. We do not all recognize it; I think maybe you do and perhaps I do, but I am not sure that all my colleagues in the Senate or in the House, or even in the administration, recognize that. In 1932, we faced a tremendous deficit and the logical thing seemed to be, under the understanding at that time, to increase taxes.

Senator DOUGLAS. Would the Senator yield?

Senator PROXMIRE. I yield.

Senator DOUGLAS. I think that what Mr. Shoup is saying is that the Members of Congress and the administration have made errors in judgment.

Mr. SHOUP. At any rate, I am hopeful that countercyclical views are gaining ground and will prevail and that all we can do is assist them to gain ground, to keep the question before us, and eventually get the correct answers.

Certainly, if we are to assume that we cannot get that view across, then, in a sense, by asking for automatic sensitivity we are almost playing a double game, because we have to give the reasons why we want automatic flexibility. Presumably, you see, those would be the same reasons why we want discretionary changes in tax rates.

Senator PROXMIRE. I think Mr. Nathan agrees with you. Still, he indicated, and I think Mr. Buchanan has indicated, some areas where we could improve and increase our automatic flexibility; improving unemployment compensation, for example; the form of our tax structure to plug loopholes; that kind of thing, so it would be more progressive in effect than it is.

Mr. SHOUP. There are some, but they do not seem to be enough.

Senator PROXMIRE. Now let me just quickly—and I do apologize for detaining you, but this is quite important to me, because it relates to something we will have to do later on this committee.

Professor Shoup, you raised the point, and Mr. Nathan, as a member of the Commission, I would like your comment, too, on this.

On page 39, it is suggested by the Commission the following:

> It is imperative that far greater efforts and funds be devoted to acquiring better information—

this is with regard to unemployment.

> The Government should institute a major program—

a major program, mind you—

> to identify the precise kind of unemployment information needed as an adequate guide for policy decisions and then to acquire the data on a timely basis.

With this in mind, the statistics subcommittee of this committee, of which I am chairman, is going to hold hearings next December, and I ask, because you have raised this point, if you could just elaborate a little bit and give us an idea of what specific kinds of information should be developed and how you think we can explore this most fruitfully.

Mr. SHOUP. Perhaps, for example, we should like to know in each case why the unemployment developed.

Senator PROXMIRE. Why the unemployment developed?

Mr. SHOUP. Yes.

In each particular, individual case. Perhaps the current gathering of data could include something on why, at least from the worker's point of view, unemployment developed. By the way, I am on unfamiliar ground here, but, anyway, it seems to me we should want to classify the unemployed according to apparent cause of unemployment, and then along with this, I suppose, would go such matters as the age and the degree of educational background of the person who is unemployed, so that we would get a better picture of the types of people who are unemployed.

Then, of course, we need, I presume, more data on the length of unemployment. We have some of that already.

And along with this would come classification by industry and by area.

In general, an endeavor to find out more than we know now why in each individual case the person in question lost his job and, secondly, seems unable to find another job.

Senator PROXMIRE. I would like, if possible, to get far more light than we have had so far on this controversy that developed before this committee, between Mr. Martin of the Federal Reserve Board and Mr. Tobin of the Council of Economic Advisers, Mr. Tobin arguing that unemployment has been largely a matter of inadequate demand, and Mr. Martin arguing that it is a matter of technological friction and people just not being skilled.

It is a matter of traning them in new skills so that they can move into the jobs that are available.

I think perhaps we can get some more information along this line, too.

Mr. SHOUP. I should hope so.

Senator PROXMIRE. Mr. Nathan?

Mr. NATHAN. I think what you are dealing with here is a sample survey that gives you good general information. This is a good job, this census job every month on unemployment.

Senator PROXMIRE. I was just going to say I was very impressed by what we had before us in the hearings that we have already had before our subcommittee. We have the best statistics by far of any country in the world.

Mr. NATHAN. No question about it, and there are very competent people in the Census Bureau.

But, when you want to pursue a subject to that degree of detail and depth which helps to make policy decisions, then you must go well beyond aggregates. Many people say—and it is involved in this Martin-Tobin conflict—that only if we could increase aggregate demand, could we solve all our employment problems.

Others say that aggregate demand is enough and that there are other problems you must attack.

Some say the other problems become manageable when aggregate demand is sufficient to bring general prosperity.

I am inclined to think that we do not have enough aggregate demand. Yet, even if you had higher levels of total demand, we would still have distressed-area problems. How do you try to figure what these problem areas are? Dr. Shoup has a good point. We must try to really understand more fully why people are unemployed.

I think we ought to do a case-by-case study of a sample of those unemployed with fairly long duration. Even when they do find employment, we should trace them a little while. We should study what happens to specific individuals in the same or identical communities and in entirely different communities.

We should note what happens if they move. We should see what happens if they take retraining courses to try to get a better perspective of what is the consequence of different techniques of solving the unemployment problem.

We ought to observe results under our redevelopment area bill where aid is provided as a specific measure to given regions. Did any industries come in through certain assistance inducements? Did certain activities emerge in response to certain actions?

It almost becomes a matter of observing enough case studies to get a pattern.

It will mean far more intensive kind of surveying than what we have done up to now. This should be in addition to, and not as a substitute for, present surveys.

Senator PROXMIRE. Thank you very much.

Just one more question. I was not here yesterday when I might have asked the question of Mr. Wilde. You have recommended that the members of the Federal Reserve Board, the Governors, be selected without geographical consideration and with more emphasis on experience and so forth.

I am very much concerned with the possible inbreeding that might develop in getting people from the banking fraternity and people with a financial viewpoint almost exclusively and not people with a broad public attitude, which I think is essential for people to make this very important policy.

As a matter of fact, the greatest shortcoming, in my judgment, of the Federal Reserve Board, is not so much a matter of competence, because, while we can always use more, the staff could fill in that, but it is a matter of being almost exclusively concerned with the technical operations of the money markets and making that run smoothly rather than with the far more important problem of encouraging our economy to grow, and, of course, working on a stable basis.

Mr. NATHAN. The last point we tried to deal with, because we do seek more coordination between the Federal Reserve and the rest of the Government. Earlier today I said to Professor Buchanan that one of the reasons why we did not deal more with automatic factors vis-a-vis the Federal Reserve Board was the unitary character of the "Fed." I was not referring to the subject of independence. I think the Commission on Money and Credit has been quite restrained in seeking to bring the "Fed" in closer alinement on economic policy along the lines you are implying, Senator Proxmire.

I do not believe we have a United States of America and a United States of the Federal Reserve. It is all one country. We all have to seek the same kind of economic objectives. Certainly, in terms of debt management, we cannot have sustained pegging of the Treasury market, as we once had.

But, nonetheless, I feel that the "Fed" must be brought in nearer to the policymaking care of our Government.

Now, what you seek in terms of broad views and capabilities is not guaranteed by geographic dispersion. What you seek in terms of diversification of background is not achieved geographically. One just has to hope and call for the outstandingly competent people to be appointed.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Senator DOUGLAS. Thank you, gentlemen.

We will resume at 2 o'clock.

(Whereupon, at 12:30 p.m., the hearing was adjourned, to resume at 2 p.m., of the same day.)

AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order. We have as our first witness Mr. Gaylord A. Freeman, Jr. Mr. Freeman, you may proceed in you own way. We have your statement here.

STATEMENT OF GAYLORD A. FREEMAN, JR., MEMBER, COMMISSION ON MONEY AND CREDIT, AND PRESIDENT, FIRST NATIONAL BANK OF CHICAGO

Mr. FREEMAN. Thank you. I would prefer to stand if I may.

Chairman PATMAN. You may do so.

Mr. FREEMAN. In order that I may use some visual aids which I have to my right.

Chairman PATMAN. Yes. May I make this statement in advance of your testimony. The topic of the hearing for this afternoon is debt management and the Government security market. We have Mr. Freeman as our witness, who is president of the First National Bank of Chicago.

After Mr. Freeman's remarks, we will hear Prof. Warren Smith, of the University of Michigan, who is a noted academic expert in this field. We are glad to have you, Mr. Freeman. You can proceed in your own way.

Mr. FREEMAN. Thank you, Mr. Chairman.

I am Gaylord A. Freeman, Jr., president of the First National Bank of Chicago, and I appear today at the committee's invitation on behalf of the Commission on Money and Credit, to discuss, not as an expert I might add, the management of the public debt, which is covered by chapter IV of the Commission's report, which you will find on pages 94 to 125 of the report. To help me with these visual aids, I have my associate, Herbert V. Prochnow, Jr., assistant attorney of our bank, with whose father many of you are acquainted.

Mr. Eccles, Mr. Wilde, and Mr. Nathan have had the opportunity of appearing before you and presenting the Commission's recommendations in the area of the Federal Reserve System, monetary policy, and fiscal policy.

The management of the public debt is related to all three of those, and is particularly related to monetary policy, as both of these affect the economy by influencing the liquidity of the economy and the structure and level of interest rates.

I would like first to discuss the pertinent facts about the public debt itself. There is no completely unambiguous way to describe the public debt. The direct debt amounts to roughly $287 billion, but of this $287 billion, $82 billion is held either in Government trust accounts, or by Government agencies, or the Federal Reserve.

The Federal Reserve has about $27 billion of such securities, and the Government agencies just about twice that amount, $55 billion.

The Government debt can be looked at in two other ways. You can consider as an offset against the $287 billion of debt about $50 billion of claims which the Government has against the private sector in mortgages that it holds, in loans on commodity credit, and in other charges that it has against the private sector alternatively you could add to the direct obligation of $287 billion a very substantial, though somewhat indeterminate, amount of contingent liabilities of the Government, the aggregate of which was estimated by Maurice Stans, when he was the Director of the Budget, at as large a figure as $750 billion.

For the Commission's purposes, we tended to look at the part of the debt owned and held by the public, excluding only the amount held by the Government trust funds, agencies, and Federal Reserve.

Chairman PATMAN. If you will pardon a suggestion, you could add directly the Federal Reserve notes as a direct liability of the Government, and they are about $28 billion.

Mr. FREEMAN. About how much, sir?

Chairman PATMAN. $28 billion. And you see, they are a direct obligation, and I understand the only reason that they are not carried as part of the national debt is because they are not interest bearing.

Mr. FREEMAN. I had not thought of that. There is a certain amount of non-interest-bearing debt in here, about $3 billion.

Chairman PATMAN. No, that would not include the Federal Reserve notes in surplus. It is possible that my estimate is high. It will run from $27 to $31 billion.

Mr. FREEMAN. But you really make the point that it is a little difficult to put your finger on one number.

Chairman PATMAN. That is right.

Mr. FREEMAN. And say that that is the debt. For our purposes in the Commission on Money and Credit, we were primarily interested in what is owned by the public, because it is what is owned by the public that has the greatest influence on money and credit.

Changes in the size and the composition of the publicly held debt have a direct effect on the liquidity of private investors.

Of the more than $200 billion of Government debt held by the public, nearly three-quarters or $150 billion out of the $204 billion is marketable. The remainder is largely in nonmarketable issues which are redeemable on demand.

It is hardly necessary to point out to so sophisticated a group as this Committee the tremendous increase in the amount of Government debt in the relatively recent years.

It is said that over 90 percent of the debt is due to the deficit financing in World Wars I and II and Korea, and the balance is largely due to the deficit financing in the 1930's.

Chairman PATMAN. I think it is so important, will you turn back to the chart that you just had. I want to mention the fact that the

marketable securities as distinguished from all the securities is so small in comparison, it is only about half or a little bit more than half.

Mr. FREEMAN. Yes.

Chairman PATMAN. And they are the ones that are traded in the open market, and turn over enough times to where there are about $200 billion worth of transactions a year, isn't that right?

Mr. FREEMAN. The figure that I had in mind is about $75 billion a year, but you are probably correct.

Chairman PATMAN. You see under Senator Douglas' leadership we had an investigation of that about 2 years ago, and I think the facts are undisputed that it is about $200 billion turnover a year. I just want to call attention to the fact that the securities aggregate less than $150 billion.

Mr. FREEMAN. Which would be about three-quarters of that held by the public, but about half of the total, that is right. You are well aware of the increase in the Government debt.

As I was saying, 90 percent of that is due to World War I, World War II, Korea——

Chairman PATMAN. Not Korea.

Mr. FREEMAN. If you will look here, this would be about 1951, and while that zig isn't very big on this graph, there was some increase.

Chairman PATMAN. It was almost a pay-as-you-go war.

Mr. FREEMAN. Oh yes, compared to World Wars I or II you are quite right. Indeed the Government debt is at a peak now, and has increased since the end of the war, the increase in the Government debt in this period since 1946 has been at a rate of only a quarter of the increase in private debt, and indeed the State and local debt has increased four and a half times the rate that Government debt has since the end of the war.

In the shorter maturities, this Government debt is very liquid and can be easily converted into cash relatively free of loss. Hence it exerts a somewhat stimulating effect on the economy.

In the longer maturities it is less liquid. It can be sold only at the risk of some loss, and hence seems to be more of a permanent investment, and exerts less of a stimulating effect on the economy.

Both the size and the maturity schedule influence liquidity and, as the Government competes with other borrowers, its cost is influenced by interest rates paid by other borrowers, and in turn the interest rates paid on the Government securities influence the cost of all other borrowings.

Now, although the Government debt is large, and is a tremendous debt owing by the Government, it is a correspondingly large asset owned by millions of individuals and corporations. The size of the public debt and the changes in its size also have other economic significance.

In the first place, the size of the debt is a principal factor in the amount of the annual interest cost which, as you know, currently is at a level of about $9 billion a year. This has to be paid in taxes, and it has some effect on the distribution of income.

But the studies made by the Commission would indicate that, although all taxpayers are not recipients of interest on Government bonds, nevertheless the very wide ownership of Government securities

today, and the steeply progressive income tax rates, have the effect of really not shifting income very much as between income groups in relation to the Government debt.

However, if the Government debt should get very much larger, then the problem of paying the interest costs might have some deleterious effects on production as it would mean that a higher charge, in the way of income taxes, would be assessed against productive enterprise.

Chairman PATMAN. Do you have a chart showing the percentage of the debt in comparison to the gross national product?

Mr. FREEMAN. No, I don't have a chart on that. As to the interest charges, if we went back as far as 1939, the interest charge was 1 percent of the gross national product.

In 1946 it got about as high as 2.2 or 2.3 of the gross national product and, in 1959, which was the last year for which I have seen the figures, it was down to about 1.6 percent.

Chairman PATMAN. Now give us the same breakdown on the debt in comparison to gross national product?

Mr. FREEMAN. I can't do that offhand. Perhaps I can get that in a minute or two.

(The information is as follows:)

The Federal public debt rose from 46.8 percent of GNP in 1939 to 109 percent in 1946, and by 1960 had declined to 47.9 percent of GNP.

Chairman PATMAN. All right, if you will, please. When you get to it though, as I don't want to interfere with your presentation.

Representative REUSS. Is it in order to ask a question?

Chairman PATMAN. I think it is well for us to ask questions that are pertinent as we go along.

Representative REUSS. On the point you have just made that the Commission has found that the wide ownership of the debt and the progressive tax system probably prevents the transfer having a significant effect on the distribution of income by the income groups, that statement that you just made is very likely the statement in the Commission's report on page 97.

Mr. FREEMAN. Yes.

Representative REUSS. Which is not documented.

Mr. FREEMAN. No.

Representative REUSS. I find, for instance, it says on page 97, in talking about bond interest on the U.S. debt:

But all taxpayers are not the recipients of interest.

Mr. FREEMAN. That is right.

Representative REUSS. I would think that that is quite an understatement, that the taxpayers and owners of the marketable debt particularly represent rather widely differing groups.

Mr. FREEMAN. Yes.

Representative REUSS. I am wondering if you could file with us the charts or work papers of the CMC on this particular point. I certainly don't want you to undertake anything that you haven't already done, but it would be valuable to us, and I am not sure that this other has been done by the committee.

Mr. FREEMAN. Yes. I would refer this to Mr. Fox, who is the head of the staff and has that available. Is it in such form that you could give it to the committee relatively soon, Mr. Fox? I am informed that it is.

(The following statement in response to this request was submitted by the staff of the Commission on Money and Credit:)

INCOME DISTRIBUTION EFFECTS OF TIGHT MONEY VERSUS INFLATION

A research study was prepared for the Commission to estimate the effects upon the distribution of personal income if there were an increase in the demand for goods and services and (1) no offsetting monetary or fiscal action were taken so that the price level rose, (2) monetary action were taken to keep the price level at its initial value, or (3) no monetary action were taken but (*a*) some tax rates were increased to keep the price level from rising, and (*b*) Federal expenditures were reduced without any offsetting change in tax rates. The estimates were necessarily crude and applied only to the "average" income receiver in each income class.

The estimates depended on an initial set of estimates of net asset positions of the average individual in each income class. These estimates aimed at determining the net debtor or net creditor position of individuals by income class taking into account not only direct holdings of interest-bearing assets such as Government bonds, savings accounts, life insurance policies, and direct debts such as mortgages, installment debt, and personal loans, but also indirect holdings of debt instruments through shares of pension funds, corporation holdings, and the like, and indirect liabilities for shares of the burden of State, local, and Federal debt. These estimates show that, on the average, individuals with incomes below about $6,000 are net creditors and those in higher income groups are net debtors.

The study then goes on to measure the effects of inflation, of tight money, and of higher taxes, respectively, on the flows of interest payments and receipts. It also estimates some effects upon the structure of the economy and the level of employment and income resulting from tight money and the alternative surplus-generating fiscal policies.

Two basic conclusions of the study are (1) uncountered inflation would, on the average inflict losses on the lower income classes (under $6,000), who are net creditors under the estimated asset distributions, and (2) the change in the pattern of interest flows due to a policy of tight money conditions to counter inflation would inflict losses on the upper income groups (over $6,000) which are net debtors, and corresponding gains to the lower income groups because of their net creditor positions. The findings are based on admittedly crude estimates, but they are the only ones known which deal with the problem on a comprehensive basis.

Representative REUSS. Thank you.

Senator PROXMIRE. Do I understand that this wouldn't make a difference if the debt were larger?

Mr. FREEMAN. I think the principle effect, if the debt were larger would be that the interest charge correspondingly would increase, and hence taxes would have to be raised in order to take care of that interest charge. This would tend to put more of a burden on the productive side of the society.

If this is carried to an extreme, it could have some discouraging effect on production sir. Exactly where that point is I don't think either of us can answer, but this could be a result of further increases in the burden of the interest charges.

Chairman PATMAN. Please pardon one more interruption on the point you are making there about the debt being widely held and so forth. Without objection I will insert in the record at this point a statement on that, and also a table, in which I show that 74 percent of the American families own not so much as one savings bond.

Mr. Freeman, you state that the Commission found that because the public debt is widely owned, interest payments do not have any significant effect on the distribution of income.

It is generally believed that savings bonds are the most widely held of any of the public debt obligations, and indeed the most widely held of any kind of debt obligation, public or private.

I want to call your attention to a survey which the Federal Reserve made in 1959 on consumer assets and indebtedness. This showed that 73 percent of the American families owned not so much as one savings bond; and 5 percent of the families owned 85 percent of all the $42½ billion of savings bonds outstanding.

My question is, did the Commission make any study, or any survey, as to how the public debt is distributed and also as to how the private debt is distributed by income groups?

Without objection I will insert in the record a table showing the holdings of Government savings bonds by family-income groups.

(The document above referred to follows:)

Estimated distribution of ownership of U.S. savings bonds among U.S. families

Minimum and maximum amount owned	Assumed average amount owned	Percent of all family spending units	Number of family spending units (millions)	Computed amount owned (billions)
0	0	73	41.5	0
$1 to $199	$100	10	5.7	$0.6
$200 to $499	400	5	2.8	1.1
$500 to $999	750	3	1.7	1.3
$1,000 to $1,900	1,500	4	2.3	3.5
Subtotal		95	54.0	6.5
$2,000 and over	12,860	5	2.8	36.0
Total		100	56.8	42.5

Source: Minimum and maximum amounts owned and percentage distributions of family spending units are from Board of Governors, Federal Reserve Bulletin, July 1959, supplementary table 7, p. 715.

Mr. FREEMAN. I think the Commission has made a study of the ownership of Government debt. I think they would add to the direct holding of the savings bonds, the additional amount of Government securities that is held for people in the way of pension funds or profit-sharing funds where they do not have it in their own physical possession, but they have ownership equity in the fund.

Chairman PATMAN. Go right ahead, sir. Pardon my interruption.

Mr. FREEMAN. Thus I think we can say on the Government debt that the size of the public debt, increases or decreases in the amount of the debt, lengthening or shortening the debt, and variations in the interest rates and the composition of the interest rates all influence the volume and the cost of money and credit. Although the Commissioners felt that it would be desirable to reduce moderately the amount of Government debt, they concluded that none of the problems posed by the existing debt is so great as to justify giving priority to a policy of debt reduction, if such a policy should interfere with a stabilizing fiscal policy.

It is desirable to reduce the debt if this can be done without any real cost to the society in the form of destabilization. But if you have a choice between exerting a restrictive influence on society at a time when it needs stimulation, or enjoying the comfort of a smaller indebtedness, the Commission would err on the side of trying to perfect a countercyclical economic policy rather than the luxury of a smaller indebtedness.

The Government, the Commission concluded, should not make the ownership of any public debt issues compulsory on the part of any group or groups of investors.

Security reserves are urged from time to time on twofold grounds. It is said that if the Government made the people buy Government bonds, this would make the chore of the Secretary of the Treasury considerably easier, as indeed it would.

It is also suggested if the people were required to purchase these bonds at an arbitrarily low interest rate, this would reduce the cost of servicing the national debt, and this too would undoubtedly be true.

However, the Commission felt that there was no merit in the suggestion. In the first place, it would be completely in opposition to our concept of economic freedom and, in the second place, it would complicate the money and capital market operations by preventing free investor choices and, thirdly, by confining one segment of investment funds to the Government, to that extent there would be a reduction in the amount available for private indebtedness, and this would undoubtedly cause an increase in the cost of private debt.

The Commission concluded that sound debt management requires that we arrest the shortening of the outstanding public marketable debt which has occurred since the end of World War II. Between 1946 and 1960 the average maturity on publicly held marketable debt was cut to less than one-half.

Chairman PATMAN. Say that again, sir, from what time to what time?

Mr. FREEMAN. Between 1946, after the end of the war, and the end of last year, 1960, the average maturity of the marketable publicly held debt was more than cut in half.

Chairman PATMAN. Give us the period, say, from 1953, early 1953 since the administration under Mr. Eisenhower was determined to lengthen the debt.

Mr. FREEMAN. I don't have that figure in mind, but they certainly didn't lengthen it.

Chairman PATMAN. I know they did not, but I wish you would put that in the record in connection with your testimony.

Mr. FREEMAN. All right. I have to turn to the Greek chorus back here.

Senator DOUGLAS. Mr. Freeman, this is a very sore point with us, because my party was criticized on the ground that we were not sufficiently lengthening the debt.

Mr. FREEMAN. Yes.

Senator DOUGLAS. And that the new administration which came in in 1953 would lengthen the debt.

My impression is the same as yours: that, instead of lengthening the debt, the average length was greatly shortened.

Mr. FREEMAN. That is is right. It is a lot easier to criticize than to achieve this.

Chairman PATMAN. That is right. Will you just put that in in connection with your remarks?

Mr. FREEMAN. Mr. Fox will supply that for the record.

This shortening of the maturity puts more and more of the debt so close to its maturity that it can be converted into cash at relatively little loss. As a consequence, it tends to increase the liquidity of the economy, and this tends to have a somewhat expansionary influence on the economy.

(The following was subsequently submitted for the record:)

Average length and maturity distribution of marketable interest-bearing public debt, 1946–60

End of period	Average years	Length months	End of period	Average years	Length months
June 30, 1946	9	1	June 30, 1954	5	6
June 30, 1947	9	5	June 30, 1955	5	10
June 30, 1948	9	2	June 30, 1956	5	4
June 30, 1949	8	9	June 30, 1957	4	9
June 30, 1950	8	2	June 30, 1958	5	3
June 30, 1951	6	7	June 30, 1959	4	7
June 30, 1952	5	8	June 30, 1960	4	4
June 30, 1953	5	4			

Source: Treasury Department.

Senator DOUGLAS. You mean through rediscount of the Federal Reserve?

Mr. FREEMAN. No; I wasn't thinking of that. Let's say an insurance company had a 20-year bond, and as it got down to within 1 year of maturity it would sell that to corporations which theretofore just had excess cash, so that it increases the amount of liquidity in the insurance company's hands available for purchases or other investments.

The Treasury should pursue a program which, over time, would lead to a more balanced and sustainable maturity structure for the debt.

Chairman PATMAN. These bills are referred to in some groups as interest-bearing currency, aren't they? They are in effect interest-bearing currency?

Mr. FREEMAN. They can be converted into currency very, very quickly; but, of course, you would run some risk that you could convert only at a price so low that the loss would more than offset the income which you would receive.

Chairman PATMAN. Yes.

Mr. FREEMAN. But I can understand the allusion.

Senator PROXMIRE. Could I ask at this point, Mr. Chairman, if it is appropriate: What is the role of the Federal Reserve in this?

Isn't it important, if this is going to be done, that the Federal Reserve follow a policy of providing or helping to provide a more stable market for long-term obligations? It seems to me that a policy, a bill's-only policy, makes it more difficult for the Treasury to move.

Mr. FREEMAN. You can make that argument, sir, two ways. You can argue that when the Federal Reserve has obligations maturing, obligations which, in the first instance, may have been 5 years or 10 years, that they might cooperate by taking securities, new securities of 2-, 5-, 10-, 20-year maturity, instead of taking only 1-year obligations or very short obligations.

This is a decision which you would certainly take if you were in the Treasury trying to fund the obligation out a little longer.

On the other hand, I believe that the Federal Reserve takes the position that its responsibility is, through monetary policy, to prevent an expansionary influence during a boom time, and to the extent that it withdraws from that longer market, it puts a burden on the Treasury of selling its obligations to the public at what will be a higher interest rate, and that this tends to have the effect of discouraging other borrowing, because the whole interest rate structure is raised and the Fed thereby exerts the restrictive influence which it should exert in such a time. This would be its point of view.

Senator PROXMIRE. But at the same time many members of this committee have expressed to Mr. Martin and the others the view that the Fed should get a more diversified portfolio, and for many, many reasons it might serve the public policy better if they had larger investments than they have, and they began to build larger investments in long-term securities. In doing this it seems to me that it would assist the Treasury at the same time to lengthen the debt.

Mr. FREEMAN. This is a basic issue between the Treasury and the Federal Reserve, and as you say, between some of your members and the Federal Reserve.

The Federal Reserve's position would be that its obligations to facilitate the Federal financing is subordinate to its obligation to follow a restrictive monetary policy in periods when it fears expansionary tendencies will lead to inflation, and that its failure to cooperate at that time is not from lack of affection but a feeling of responsibility to prevent the easier credit conditions which its participation would have brought about.

Senator PROXMIRE. Certainly in any other period, a period such as this which is said to be easy money times, then it can cooperate in providing a market which would help lengthen it.

Mr. FREEMAN. I don't know that the Commission took a point of view on that.

It would seem to me that it would be very difficult to answer your point. It would appear, however, that the Federal Reserve has recently been doing what you suggest. Since the middle of February it has added about $3.6 billion to its holdings of Government securities maturing in more than 1 year and reduced its holdings of less than 1 year maturities by a similar amount.

Senator PROXMIRE. Thank you.

Chairman PATMAN. You may proceed in your own way, sir.

Mr. FREEMAN. Thank you. There are two limitations, however, on the opportunity to use debt management as a countercyclical tool.

In the first place, to lengthen the debt in a period of boom means that you are putting out that much of the debt for a long time at what are necessarily higher interest rates, the interest rates prevailing at the time of the boom. As a consequence, the utilization of countercyclical policy in this respect does tend to cost more.

This is a limiting factor, maybe to the point where you feel that you shouldn't do this.

Secondly, and unfortunately, there is a pretty close limit on the absorptive capacity of the market to take long securities during a period of boom, because the insurance companies, the other large investors, don't want to reach out at that time for a long period.

As a consequence, though we believe that the management of the marketable debt can exert some stabilizing influence, we believe that the principal responsibility for achieving this objective must be borne by monetary and fiscal policies rather than by debt management.

Representative GRIFFITHS. If, however, you compel everyone to take part of the debt at a low rate of interest during a period of boom, wouldn't that be deflationary?

Mr. FREEMAN. If you did it compulsorily, if you made everybody buy a long debt at a low rate in the boom, yes. This would have a restrictive or anti-inflationary effect. Yes, it would.

It would take the money that they might otherwise spend for an automobile or an icebox or a house out of the stream. This would be true.

This would, however, in effect be a capital levy or a tax. If it were to be imposed it could be justified only as a part of an overall tax program, and recognized as a capital levy rather than a mere instrument of debt management. It would be so severe in action to achieve moderate gains that it would not be worthwhile unless it were incorporated as a part of a tax program of capital levy. The Commission recommended against this and so would I.

The Commission concluded that the development of a balanced and sustained maturity structure for the debt will require some rearranging of the publicly held debt, including some movement of the debt into longer maturity categories.

The transition to a more balanced structure should be made during the periods of buoyant economic activity, if we are to use this action as a countercyclical tool.

The Commission concluded that the Treasury should take measures to expand the proportion of the public debt in the form of savings bonds on terms which are competitive with yields of suitable alternative forms of investment for small investors.

The value of savings bonds, and there are several values, is that they do encourage thrift, they do tend to put the money away for some while because though the saver can cash them in, the saver tends to think of it as an asset that he has put away and he doesn't liquidate them to the same extent that other holders might——

Chairman PATMAN. I would like to ask you a short question on that.

Mr. FREEMAN. Yes.

Chairman PATMAN. It occurs to me that that is against our private enterprise system. You are encouraging people to invest in long-term Government bonds or short term at a good rate of interest that is satisfactory to them, whereas under our private enterprise system, they shouldn't have such an attractive investment. It should be lower so they would be attracted by the investments in small business and private enterprise.

Mr. FREEMAN. You are right, Mr. Chairman, except that the Government debt has to be financed, too.

Chairman PATMAN. I know, but there are other ways. The Federal Reserve can finance any part of the Federal debt.

Mr. FREEMAN. Well, yes, there are other ways, Mr. Chairman. But I think the alternative to financing either through individuals or corporations, because your argument now goes far beyond just the question of the savings bonds——

Chairman PATMAN. I wish you would pick up just that one question. Is it right that we offer such an attractive investment in Governments that people will be deterred from investing locally?

Mr. FREEMAN. It would seem to me not only to be right but to be necessary, because I would feel that the Government obligations have to compete. The people don't have to buy them. If the people are to buy them, they should buy them because they are as attractive as alternative available investments.

Chairman PATMAN. But you are putting the private enterprise system out of business.

Mr. FREEMAN. No, we aren't. There is room for both, and the alternative of financing the Government indebtedness either by printing money or creating money indirectly through having the Federal Reserve buy the obligations would lead, over a period of time, to such expansionary or inflationary policies that I would believe that private enterprise would be much more stifled than it is handicapped by the lack of funds available, which now go into the Governments as distinguished from corporate or individual obligations.

Chairman PATMAN. I think you are giving too much importance to that part of the savings bonds that are purchased by the people generally. That only aggregates about one-sixth of the national debt.

Mr. FREEMAN. My discussion with you was not limited to savings bonds. My argument that we should use the savings bonds more is a relatively modest argument that this does encourage thrift.

Chairman PATMAN. You take another look at what you are advocating there. You might be on the wrong side on this thing.

Mr. FREEMAN. I might be, because I am not awfully sharp, but I don't think I am on the wrong side there. I think I am right about that.

But one element that we might discuss in passing in connection with this, is that to encourage people to buy savings bonds, it is sometimes suggested that you might gear the ultimate payment to some cost-of-living index, or attempt to provide a constant purchasing power to the bonds when they subsequently came due.

Chairman PATMAN. Our committee, for your information, passed on that and turned it down unanimously.

Mr. FREEMAN. Well, so did we.

Chairman PATMAN. About 2 or 3 years ago.

Mr. FREEMAN. So we don't need to discuss that at any great length.

The Commission does not favor—and this might seem obvious, but I would like to discuss it a minute—consolidating the Treasury and the Federal Reserve as a means of coordinating debt management and monetary policy.

Certainly we would all feel that it is highly desirable that Treasury operations and Federal Reserve operations be conducted in such a way that they are not inconsistent or interfere with one another.

This suggests that they be coordinated in some way. Now it would be theoretically possible to make the Federal Reserve subordinate to, or perhaps even a part of, the Treasury. But we would find this undesirable, primarily because the Treasury would thereupon be caught in a very severe conflict of interest.

On the one hand, it is the largest borrower in this society, and hence would have a very strong interest in keeping interest charges as low

as possible. On the other hand, it would have the monetary policy responsibility, which would involve increased interest rates and limiting the amount of funds available for investment during periods when they felt that the threat of inflation required such a policy. So putting responsibility for monetary policy into the Treasury did not seem like a practical solution.

There is an alternative. You could turn over the responsibility for the Government debt to the Federal Reserve. Here you have the same conflict, but in a different house, and in addition I would assume that it would be politically impossible to induce any President or Secretary of the Treasury to give up their responsibility for the management of the debt, and to turn it over to any other agency, particularly a semiautonomous agency like the Federal Reserve.

It is obvious that there is need for some coordination of the Treasury and the Federal Reserve actions, and I think that Mr. Wilde yesterday discussed the need for and method of coordinating the two.

The Commission concluded that the range of discretionary debt management authority exercised by the executive branch should be broadened. Specifically, they would recommend that the debt ceiling and the interest rate ceiling should both be eliminated.

The debt ceiling has been defended on the ground that it is an inducement to fiscal responsibility and a curb on spending, but it has not had this effect.

The Treasury finds itself in the position where it has to provide funds for the appropriations made by Congress, and it has to dig up the money. The existence of the debt ceiling has, in the past, caused the Treasury to attempt devious and expensive devices for raising money without actually violating the debt ceiling.

As a consequence, since it has had no demonstrable effect on Congress appropriations and since it has put the Treasury in a position of turning to devices which are more expensive than straight Treasury borrowing, we feel that it serves no useful purpose and should be abandoned.

Similarly we think that the 4¼ percent ceiling on bond interest rates should be eliminated, because it has accomplished nothing of any usefulness we believe. In fact, it has had the opposite effect in several instances of causing the Government to pay a higher interest rate than it would have had to pay had there been no such ceiling.

If the Treasury is to finance the Government debt, it must do so by issuing obligations which are competitive in the market with other debts that are available.

Chairman PATMAN. Will the gentleman yield?

Without objection I would like to place in the record at this point comments on what the witness has just said, without interrogating him about it, because I am certainly in opposition to your recommendation that the interest rate ceiling of 4¼ percent be eliminated. I think we have saved hundreds of millions of dollars by reason of that limitation. I am sure we have an honest disagreement; I will put my reasons in the record.

I will insert in the record a memorandum prepared by Dr. Paul G. Darling, professor of economics, Bowdoin College, who served on the staff of the Joint Economic Committee during the past summer.

In estimating what the increased interest cost on the Federal debt would be today if Congress had repealed the interest-rate ceiling when the Eisenhower administration first began asking for repeal, Dr. Darling makes two assumptions as to (*a*) the amount of the debt that would have been shifted from short-term Treasury bills to the long-term bonds, in order to accomplish the lengthening of the debt which the administration said was the purpose of the proposed repeal, and (*b*) the interest rate at which these long-term bonds would have been sold. The first assumption is that the administration would have lengthened the average maturity of the outstanding debt to at least what it had been at the end of 1952, and to accomplish this the administration would have sold a little over $18 billion of 10-year bonds and retired an equal amount of 91-day Treasury bills. The second assumption is that the administration would have put an interest rate of 5 percent on those long-term bonds.

These are very conservative assumptions indeed. Under the degree of monetary tightness which the administration was maintaining at that time it would have been very difficult to sell any substantial amount of long-term bonds at 5 percent, particularly in view of the market expectations then prevailing. The big investors fully expected that if the administration succeeded in getting Congress to repeal the interest-rate ceiling, the administration would then raise long-term rates up into the stratosphere. So, an assumption that the administration would have issued long-term contracts at 5-percent interest seems, as I say, very conservative. It is not unlikely that the administration would have sold these bonds at an interest rate between 5½ and 6 percent.

However, if we accept the conservative estimate of a 5-percent interest rate, this shift of approximately $18 billion of Government debt from Treasury bills to long-term bonds would be costing the taxpayer now, in the year 1961, an additional $477.2 million in interest charges—and for the same amount of debt.

An extra $477.2 million in interest charges per year would mean that over the 10 years after President Eisenhower left office the increased interest charges on the Federal debt would have amounted to $4.8 billion, even if we assume that the Kennedy administration never does succeed in reducing short-term interest rates much below the high levels inherited from the Eisenhower administration. In other words, if Congress had yielded to the administration's pressures and repealed the 42-year-old interest-rate ceiling on Government bonds, this would have cost the taxpayers an added $4.8 billion—as a minimum—and it is quite likely that by refusing to repeal the ceiling Congress has actually saved the taxpayers much more than $4.8 billion.

Whatever theoretical arguments might be made on behalf of lengthening the debt during 1959 and 1960, one fact is plain: By its refusal to repeal the interest-rate ceiling, Congress has saved the taxpayers almost $4.8 billion a year in unnecessary interest charges on the Federal debt.

(Dr. Darling's memorandum is as follows:)

MAY 26, 1961.

To: Hon. Wright Patman, chairman.
From: Paul G. Darling.
Subject: Added interest burden for stretchout of Federal debt at high long-term interest rate.

1. On June 8, 1959, the Treasury requested Congress to remove the 4¼-percent statutory ceiling on bond issues of maturity exceeding 5 years. A calculation is required to indicate how much the added interest burden on the marketable public-held debt would have been if the ceiling had been removed and the administration had then proceeded to restore the average maturity of this debt to where it stood in December 1952.

2. The following assumptions underlie the calculations of this memorandum:

a. The stretchout would have been undertaken during the last half of 1959 and a 5-percent coupon would have been necessary to market at par bonds of 10-year maturity or over.

b. The stretchout would have been accomplished by substituting bonds of 10-year maturity or over for Treasury bills.

c. The Treasury bill rate prevailing during the early months of 1961 (i.e., the average January–April 1961 rate of 2.364 percent), is expected to continue over the foreseeable future as an average cost to the Government in raising short-term funds. (In view of balance-of-payments problems which are likely to persist for a number of years, this assumption may not be unrealistic.)

3. The average maturity of the marketable public-held debt on December 31, 1952, was 67 months, and on June 30, 1959, it was 55 months. Thus, 12 months would have to be added to the average maturity on June 30, 1959, to restore it to its earlier status. Two alternatives are considered to accomplish this:

a. Case I: Sell $18,104 million of 10-year bonds and retire an equal amount of Treasury bills.

b. Case II: Sell $6,001 million of 10-year bonds and $6,001 million of 20-year bonds and retire $12,002 million of Treasury bills.

4. The added interest burden on the Federal marketable public-held debt of June 30, 1959, if this debt had been stretched out as described, is calculated as follows:

Case I—$18,104,000,000 of 10-year bonds substituted for like amount of Treasury bills:	
Add interest: $18,104,000,000 bonds at 5 percent .... million..	$905.2
Subtract interest: $18,104,000,000 bills at 2.364 percent .... do....	428.0
Net added interest burden per year .... do....	477.2
Net added interest burden over 10-year period .... billion..	4.8
Case II—$6,001 of 10-year bonds plus $6,001 of 20-year bonds substituted for $12,002 of Treasury bills:	
Add interest:	
$6,001 of 10-year bonds at 5 percent .... million..	300.1
$6,0001 of 20-year bonds at 5 percent .... do....	300.1
Total .... do....	600.2
Subtract interest: $12,002 bills at 2.364 percent .... do....	283.7
Net added interest burden per year .... do....	316.5
Net added interest burden over 10-year period .... billion..	3.2

5. It may be of interest to make a similiar calculation assuming that the stretching out took place during the early months of 1961. In this case, it is assumed that the coupon necessary to market bond issues of 10-years maturity and over would be 4 percent:

Case I—$18,104,000,000 of 10-year bonds substituted for like amount of Treasury bills:	
Add interest: $18,104,000,000 bonds at 4 percent .... million..	$724.2
Subtract interest: $18,104,000,000 bills at 2.364 percent .... do....	428.0
Net added interest burden per year .... do....	296.2
Net added interest burden over 10-year period .... billion..	3.0

Case II—$6,001 of 10-year bonds plus $6,001 of 20-year bonds substituted for $12,002 of Treasury bills:

Add interest:		
$6,001 of 10-year bonds at 4 percent	million	$240.0
$6,001 of 20-year bonds at 4 percent	do	240.0
Total	do	480.0
Subtract interest: $12,002 bills at 2.364 percent	do	283.7
Net added interest burden per year	do	196.3
Net added interest burden over 10-year period	billion	2.0

Mr. FREEMAN. The recent opinion of the Attorney General makes this a little less important, since he has said that to sell 4¼ percent bonds at a discount is not a violation of the present restriction.

However, it would be more effective to change the statute rather than to use the Attorney General's opinion, which somewhat circumvents the present statute. If he is right that the Congress intended to repeal that limitation, it would be wiser to go ahead and repeal it directly so that there would be no uncertainty about that.

Representative REUSS. May I comment at this point that I think there would be a roar of outrage from Congress if any administration attempted to take advantage of the Attorney General's legal opinion to evade the 4¼ percent ceiling by selling bonds at a discount. I recall that the Eisenhower administration was aware of the fact that though there was an outside legal possibility of taking the shortcut, it felt that it would be a breach of faith with the intent of Congress to take this course. I hope very much that no administration would attempt to issue long term securities bearing a coupon in excess of 4¼ percent or to sell at a discount without a change in the law. I do think Congress thought it was imposing a ceiling.

Mr. FREEMAN. Secretary Anderson did say that he felt that to rely on such an opinion might seem to be circumventing, was his word, the intention of the Congress. I would not want to express a legal opinion on that one way or the other.

Representative REUSS. You are quite right that the Attorney General did rule exactly as you have said.

Mr. FREEMAN. That is right, and there is a good deal of merit to it. You are experienced in this field, much more than I. But the administration has been put, in the course of the last few years, I think on several occasions, in 1958 and 1959, to the use of shorter maturity certificates that carry higher interest rates than the 4¼ percent, because they could not pay above the 4¼ if they went to the longer maturities.

Representative REUSS. It was a good thing that the higher interest rates were confined to short-term maturities. Many of these have since matured, and longer term issues can now be marketed under the ceiling.

Mr. FREEMAN. Yes. It turned out that at that time there was a sufficient downturn in the economy and in interest rates so that it was a good thing perhaps that it wasn't frozen at 4¼, and that it issued shorter securities at 4½ or 4⅞ or whatever the figures are that they used. That is right.

But, it is certainly conceivable that at other times there would not be a reversal of the trend in interest rates so rapidly. In any event, the Commission felt that for the flexibility which any adminis-

tration should have, the interest rate ceiling as well as the debt ceiling should be eliminated.

Chairman PATMAN. You don't know of any association of bankers that has recommended that the Government sell its bonds at discount in violation of that rate, do you?

Mr. FREEMAN. No, I don't. There may have been some group, but I don't know of any.

Chairman PATMAN. I don't know that anybody would do that. That looks to me like it is morally wrong. I would hope the Attorney General would take another look at that opinion.

Mr. FREEMAN. I would say this: If they are going to do it, the bankers would much prefer to have you repeal rather than to rely on——

Representative REUSS. The latter would be much worse the way I see it.

Senator PROXMIRE. Could I ask hasn't there been a long-term secular tendency for interest rates to decline in this country? The reason I ask that is it seems to me that 4¼ percent is something we have had for some time, and actually it represents a greater degree of discretion for the Secretary of the Treasury than he had before. It previously was necessary, I think, for Congress to authorize each issue and specify the interest rate.

Mr. FREEMAN. That is right.

Senator PROXMIRE. So this gave him a great deal of flexibility compared with what he had before. We had it for many years, and up until very recently it wasn't a serious problem. In view of the long trend, the secular trend downward, I can't understand why it is so important to raise interest rate ceilings now.

Mr. FREEMAN. Well, I don't know that I would say that there is a long-term secular trend downward. Interest rates declined substantially during the period of the depression, and they were artificially maintained at a comparatively, or at least artifically, low level for a substantial period of time.

They have climbed up to levels comparative with predepression levels, but only momentarily in the last few years, because of relatively rapid turns in the business cycle.

I would hesitate to say that this shows any long-term trend. I would be inclined to doubt that it does, but my knowledge is not such as to allow me to say it either way with great conviction.

Senator PROXMIRE. I was only speaking in terms of the tendency of the country which has settled and matured, the risk is diminished, there is a tendency for interest rates to fall, over time.

Mr. FREEMAN. Yes. I would think that there is perhaps more capital in relation to our needs than there was a hundred years ago. As a banker I would not be convinced that there was less risk. But your observation may be true.

Related to this problem is another one that I might quickly mention in passing.

It would be highly desirable in the administration of the Government debt if there were fewer issues of bonds, so that there wasn't something maturing every hour and a half. The Government has to go to the market so often now that the market is a little disturbed at all times.

In order to have fewer obligations, since you can't start out and sell $20 billion of a 30-year bond, it would be desirable to be able to sell some of an issue and then subsequently sell more of that same issue.

If interest rates have gone down in the meantime, so that the Government gets something beyond par when it sells the subsequent group of bonds, there is no problem. But if interest rates have gone up and the price of securities has declined, the Government finds it difficult to sell additional bonds of the same issue, because if they sell them, as they would have to sell them at a discount below par, the purchaser can only take one-quarter of 1 percent for each year from the date of issue to maturity as a capital gain, whereas if he buys those bonds that are already outstanding, he can take all of the discount as capital gain at the end of the period.

Hence, we would recommend that to make it more feasible to come back and sell additional bonds of an existing issue it would be desirable to make a change in this section of the Internal Revenue Code, section 1232.

This would cost the Government almost nothing in the loss of revenue. It would make it possible to space the debt in larger blocks and to sell fewer issues, by opening up existing issues.

The Commission concluded that the Treasury should continue to experiment with advance refunding techniques as a means of achieving debt extension. Let us say that the Government issues a 30-year bond; it is likely to be purchased by a pension fund or an insurance company. Now as that bond gets closer to maturity, when it just has 1 or 2 years to run until maturity, it is likely to be sold by the insurance company to a short-term investor, perhaps a corporation, perhaps a bank, perhaps a savings and loan. Then when the Government comes to refund it, that new owner doesn't want to refund it for more than a year or two. He is a 1- or 2-year holder.

In order to refund the issue for a long term it is desirable to refund it before it has gone out of the hands of the original long-term investor.

As a consequence, we believe that the Treasury would find it easier to keep the debt spaced out at some extended maturity if it were to refund some time in advance of maturity.

The Commission concluded that the Treasury should also continue to experiment with the use of the auction technique, and allow the market to determine the interest rates. This removes the responsibility from the Treasury, and we feel that it would be desirable to at least experiment with this over a wider area of maturities.

We think that in the long run the Treasury would be able to sell its securities at a somewhat lower interest rate than it does now.

Senator DOUGLAS. Mr. Freeman, I am very glad you made this recommendation, because some of us have urged this on the Treasury in past years, and, there was virtually no response.

But Secretary Dillon has said that they intend to make some experiments in this. It seems to me that if one believes in a competitive system, that one should have competition in determining the price of the bonds.

We have competitive bidding now in the case of bills, but the bonds are issued at par, and almost uniformally they are oversubscribed with the number demanded being two or three times the amount issued.

Mr. FREEMAN. That is right.

Senator DOUGLAS. This would indicate that in a competitive market, the price would be higher than par, and therefore the yield would be less than the interest rate.

Mr. FREEMAN. Yes.

Senator DOUGLAS. Now, I am delighted that you have said this, because this was one of the big points of dispute between this committee and the Eisenhower administration.

Chairman PATMAN. And Senator Douglas.

Senator DOUGLAS. So I am delighted by this. I am greatly pleased by this. There was no dissent on this, was there, within your committee?

Mr. FREEMAN. I don't believe there was. I don't recall that there was any dissension in the committee discussions.

There was a feeling, with which I am sure you will not only agree but probably originated, that when the Treasury goes to market with an issue, it has to price it at a level where it is confident that it is going to sell, because it would be humiliating to the whole country if the Treasury couldn't sell its obligations. Hence there is a tendency to be careful enough that you are giving enough so that you should——

Senator DOUGLAS. Or generous enough with the interest rate. So ——

Mr. FREEMAN. That is right.

Senator DOUGLAS. So as to make certain that it is going to be oversubscribed.

Mr. FREEMAN. That is right. This would probably tend to be the truth, not very much, but a little bit. And the auction technique should have the effect of holding that interest charge down. I think that is right.

Senator DOUGLAS. I am greatly pleased.

Mr. FREEMAN. Although the Commission does not favor broad authority over margins for the secondary market in Government securities, it does recommend that minimum margins, such as those now set by the New York Stock Exchange and the Comptroller of the Currency—for those that are governed by them—be applied by various other supervisory authorities to presently nonregulated lenders including nonfinancial corporations.

As you know, the New York Stock Exchange requires of its members that if they are making a loan on the Governments, they must have a margin of at least 5 percent. The Comptroller of the Currency has established a similar rule for national banks.

On the other hand, State banks are not regulated nor are States and political subdivisions, or large business corporations, which have done a good deal of financing through the vehicle of repurchase agreements.

You will recall the study by the Treasury and the Federal Reserve of that unfortunate experience in 1958, when there was so much borrowing on a new issue, and when interest rates rose just at that time. This made that issue less desirable, the market fell, and as many borrowers had no margin to protect them they had to be sold out. This led to even greater declines in the market.

Chairman PATMAN. And you are recommending 5 percent for all financial institutions, whether regulated or not.

Mr. FREEMAN. That is the recommendation, yes, sir.

Chairman PATMAN. You endorse 5 percent. Doesn't that seem awfully low? You can take $50,000 and buy $1 million worth of bonds that way.

Mr. FREEMAN. It is low, but it is much higher than nothing.

Chairman PATMAN. On listed stocks it is 70 percent, isn't it?

Mr. FREEMAN. Yes, but I don't think you would want to get into anything like that, Mr. Chairman.

Chairman PATMAN. I am not advocating that much, but 5 percent seems awfully low.

Mr. FREEMAN. What we are looking for here is not anything that discourages the purchase of the Governments. We are just looking for enough of a margin to avoid the probability of any wholesale liquidation of these, because they decline in the market. And a 5-point decline in the market for Governments, within a relatively short time after issuance is quite unlikely.

Chairman PATMAN. Oh, yes.

Mr. FREEMAN. A 5-point margin would be adequate.

Chairman PATMAN. I agree it certainly should be that much. But I am surprised that you would advocate a 5-percent margin even on Government bonds.

Mr. FREEMAN. This is what the Comptroller feels is necessary, all that is necessary to protect the banks.

Chairman PATMAN. That is right. You know more about it than I do.

Mr. FREEMAN. You know about it than I do too.

Chairman PATMAN. I am not arguing with you.

Senator DOUGLAS. I just came back in, Mr. Freeman, but I am surprised that you fixed the margin as high as 5 percent, because in our investigation of the securities market, we found that a 5-percent margin existed for only a relatively small fraction of the transactions.

Mr. FREEMAN. Yes.

Senator DOUGLAS. And the vast majority of the transactions had no margin at all.

Mr. FREEMAN. That is right.

Senator DOUGLAS. And never in my wildest dreams did I think that we would suggest a margin as high as 5 percent. I find myself the soul of moderation compared with you on this issue.

Chairman PATMAN. I am not advocating it.

Mr. FREEMAN. I shouldn't have written that 5 percent quite so large or in red ink. But we recommend a minimum such as is now set by the New York Stock Exchange and the Comptroller. It happens to be 5 percent in the case of the Comptroller and the stock exchange.

Senator DOUGLAS. That applies to only a very small fraction of the total transportation.

Mr. FREEMAN. Yes, but our recommendation is that it be extended to all, Senator Douglas, that it be applied by various supervisory authorities to presently nonregulated lenders, including nonfinancial corporations, because as you would know better than I, there has been a good deal of lending by large business corporations through the vehicle of repurchase agreements from the bond dealers.

Senator DOUGLAS. I think this is certainly a great step forward, and I want to congratulate the Commission on this point also.

I believe that we should have margins, but I have never thought that we could get the financial community to agree to a margin as high as 5 percent.

Chairman PATMAN. Well, now, is that wishful thinking? How are you going to compel these State authorities to do that?

Senator DOUGLAS. You really mean the New York authorities.

Chairman PATMAN. What would be your method of approach? How would you enforce it?

Mr. FREEMAN. I am not sure, but I would think that the Federal Reserve through—I don't know, I am not sure of the source of the Federal Reserve's authority to issue regulations U, S, and T, but I would think that the Federal Reserve probably has authority to do that.

Chairman PATMAN. The Federal Reserve member banks obviously, but banks that are not members would have no authority.

Mr. FREEMAN. My feeling was that the authority to the "Fed" to issue regulations S, T, and U, as I recall, covers all loans on listed securities——

Chairman PATMAN. It is W, I think.

Mr. FREEMAN. No, not W. That is the consumer credit regulation. It is U for the commercial banks and I think S and T for the brokers and dealers.

Senator DOUGLAS. You mean that that could be applied to Government securities as well?

Mr. FREEMAN. I think so. It applies to all securities listed on the National Securities Exchange, and I think that these Government securities are listed on the exchange although there are very little traded on the exchange. They are listed.

Chairman PATMAN. They are not listed. It is overmarket, overcounter.

Mr. FREEMAN. Well, they are listed, but Mr. Fox reminds me that the provision in the Securities and Exchange Act, by which Congress gave the Federal Reserve the authority to make these margin requirements over all listed securities—no matter who is the lender—specifically exempted Government bonds. I think by an act of Congress you could remove that exemption, whereupon all loans on the Governments could be subjected to such a regulation as this.

Senator DOUGLAS. Then you would not be opposed to an act of Congress in this direction?

Mr. FREEMAN. No, sir. As a matter of fact, that would be the recommendation of the Commission.

Senator DOUGLAS. I again want to congratulate the Commission.

Mr. FREEMAN. We are late but we are right.

The Commission concluded that because the present market for Treasury securities is the outgrowth of dealer competition to meet the needs of market participants, the Commission made no recommendations in regard to market structures.

The recent studies that have been made show that the present over-the-counter market made by 19 dealers operates efficiently. Active competition prevails and dealer trading profits per dollar of sales are small, also per dollar of investment.

Chairman PATMAN. You say active competition prevails?

Mr. FREEMAN. Yes, sir.

Chairman PATMAN. Do you certify to that yourself?

Mr. FREEMAN. Yes, sir, and that is one thing that I can certify to, yes, sir.

Chairman PATMAN. You see we were over in New York under the chairmanship of Senator Douglas, and we had a hearing over there, and we had these dealers up before our committee, and I got the impression that these dealers all had offices right there within a stone's throw of the Federal Reserve, and although you are a Chicago dealer you have an office down there I believe.

Mr. FREEMAN. Yes, we do.

Chairman PATMAN. And it is just like a country telephone line on the same telephone at the same time, is that right?

Mr. FREEMAN. Well, no. It is not like a country telephone line. We are all connected with each other by telephone lines.

Chairman PATMAN. That is what I say, just like a country telephone line.

Mr. FREEMAN. But they don't all listen in, that is the difference.

Chairman PATMAN. And I don't see much active competition in a case like that.

Mr. FREEMAN. Oh, but there is because we are trading for ourselves. We would just love to nick the Bankers or the Continental or the Chemical or one of the other banks. We are each dealing as principals in these trades, so that there is severe competition.

Chairman PATMAN. I am glad to know that you think that. I hope you are right.

Mr. FREEMAN. Not only do I think it; when I look at our profits from this business, I know it is competitive, because it is the least profitable part of our business.

Chairman PATMAN. As a bank, but I am not talking about the dealers, you know. You are not in it 100 percent. You are just in it a little bit in comparison to the dealers. You see, the banks are in a little different category the way I see it.

Mr. FREEMAN. Yes, though we handle a very large volume of this.

Chairman PATMAN. But it is sort of a sideline for you.

Mr. FREEMAN. That is right, it isn't nearly as important to us.

Chairman PATMAN. But these dealers make pretty good money. You know Mr. Eccles broke down and confessed—I will change that. I shouldn't say that. One time we were asking——

He told us how lucrative that business was, and that was a long time ago, and they have learned a lot since that time.

Mr. FREEMAN. If so, they are smarter than the banks, or at least they are smarter than our bank. We don't make much money on our trading in Government securities.

Related to this, the Commission studied the question of dealer financing facilities, and concluded that it does not recommend direct access to the Federal Reserve by dealers on their own initiative, because such a procedure may conflict with an effective monetary policy.

Chairman PATMAN. Mr. Freeman, instead of asking you any questions, may I file these with the reporter, and when you get your transcript, you will see them and answer them at that time, please?

Mr. FREEMAN. Yes, sir.

Chairman PATMAN. Will that be satisfactory, and any other member may do the same thing if he desires.

Mr. FREEMAN. I will undertake to do that to the best of my ability.

QUESTIONS SUBMITTED TO, AND ANSWERS BY, GAYLORD A. FREEMAN, JR.

1. Mr. Freeman, in your statement, you remark that "security reserve requirements" are "contrary to our concept of economic freedom." Is that not equally true of cash reserve requirements? Are you opposed to those on the same ground?

Answer: Cash reserve requirements for commercial banks were adopted initially to assure that banks had adequate cash resources to cover unexpected withdrawals of deposits. With the development of deposit insurance and bank examination procedures, however, the liquidity reserve function of cash reserve requirements has become less important. At the same time, the evolution of central banking techniques under the Federal Reserve System has given cash reserve requirements the newer and important function of a fulcrum upon which Federal Reserve monetary policy actions obtain their leverage. The existence of a cash reserve requirement expressed in terms of a percentage of total deposits makes it possible for the Federal Reserve System, by controlling the cost and availability of bank reserves, to influence the rate of growth of the money supply and the availability of commercial bank credit.

The Commission recognized that some form of reserve requirement is a necessary part of our apparatus for regulating money and credit, and considered that the present cash reserve requirement was satisfactory for this purpose.

A security reserve requirement, in addition to or in lieu of cash reserve requirements, could be used to the same purpose. The question however, is whether an additional reserve requirement would improve the Federal Reserve System's ability to regulate money and credit. The Commission did not think that this would be the case. Therefore, security reserve requirements were considered as a means of insulating a portion of the public debt from market forces and of reducing its interest costs. This would, however, be equivalent to a special tax on those institutions required to carry a security reserve.

Speaking for myself and not for the Commission, I might add that I have reservations about the need for a fixed cash reserve requirement in all phases of the business cycle. During recessions, when the Federal Reserve System is attempting to promote money and credit growth, the reserve requirement is largely meaningless since the Federal Reserve stands ready to supply additional reserves promptly as they are needed to support deposit growth. I believe it would be feasible to develop a system, similar to that employed by the Bank of England, under which cash reserve requirements might be reduced to zero when monetary policy is aimed at promoting credit and might then be increased in steps as the object of policy shifts to restraint of credit. In short, while I would not oppose the present system of cash reserve requirements as "contrary to our concept of economic freedom," I might question the need for it as presently constituted. The Commission took a somewhat different view in recommending (on p. 67):

"The Commission believes that the power to change reserve requirements should be used only sparingly and favors major reliance on the use of open-market operations for countercyclical adjustments."

2. What was the Commission's objection to the Federal Reserve making money sufficiently easy in recession times that the Government could issue long-term debt in these times without raising interest rates.

Answer: The Commission recommended that steps be taken to develop debt management as an instrument of countercyclical economic policy, and that such use of debt management include some lengthening of debt maturity in periods of boom and inflation and some shortening during periods of recession. The Commission's report did not deal explicitly with the possibility that the Federal Reserve could make it possible to permit lengthening the debt even in a period calling for "easy money" through adoption of a policy sufficiently easy to offset the restrictive effect of Treasury debt lengthening at such times (or, conversely, sufficiently tight in boom periods to offset the greater liquidity resulting from debt shortening at those times).

It is of course true, as the Commission report points out, that debt management and monetary policy are closely related in the type of influence exerted upon th eeconomy, and it follows that ideally they should operate together, but if desirable either one might be used as a partial offset to the influence being exerted by the other. In fact, this is precisely what has happened most of the time during recent years, as Federal Reserve policy has been called upon to

compensate for debt management policies that have lengthened debt in recession and shortened debt maturities in periods of boom. The Commission's position is that it is not necessary that debt management be out of step with monetary policy. My personal conviction, as I expressed it orally, is that the Commission's position is right once the debt is fairly well spaced, but to get it extended from the too short maturity we now face may require extension at times of available funds and lower interest rates. However, once the debt is reasonably spaced, then, as the Commission suggests, there will be opportunities to develop debt management as at least a moderately effective instrument of national economic policy. Undue reliance upon monetary policy to do not only its own job but also to compensate for procyclical debt management policies tends to create distortions in the economy that may involve too heavy a price for our unwillingness to develop effective countercyclical debt management policies.

3. Mr. Freeman, you have said that the Commission is opposed to the idea of the Government issuing constant purchasing power savings bonds because of what you call the inflationary bias inherent in such an innovation (p. 7). Is the Commission also opposed to the insurance companies selling veriable annuity policies? Or did the Commission consider this question?

Don't variable annuity insurance policies have the same "inherent inflationary bias" which the Commission sees in constant purchasing power bonds?

Answer: The Commission did not consider the variable annuity policies offered by some insurance companies and did not therefore comment upon any inflationary bias that might be inherent in the development of such instruments. I believe, however, that variable annuity policies may contain some of the same type of inflationary bias as constant purchasing power savings bonds. In both cases, the tendency is to weaken the resistance of small savers to inflation. Given the powerful forces in our economy toward inflation, it is precisely this group of small savers who must be relied upon as the principal source of opposition to inflation. I certainly do not believe that the Federal Government through its debt management policies should give added support to any policy that would weaken the public's concern for a stable currency.

4. Mr. Freeman, in your statement, you say that the size of the public debt is one of the determinants of the interest cost for servicing the debt. This is a determinant which is related also to the size of the money supply, is it not?

In other words, if the Federal Reserve makes money available, then the interest rate on a large debt need not be any larger than the interest rate on a smaller debt.

Answer: Federal Reserve policy is an important determinant of interest rate levels. The Federal Reserve Board has the power to hold down interest costs on the public debt by pumping out money in such quantities as might be necessary to hold interest rates at low levels. But the inflationary consequences of such a policy are very apparent. The Federal Reserve System did precisely this during the few years immediately following the Second World War, and the inflation to which we have been subjected for the past 20 years is in part a direct outgrowth of this monetary policy.

5. You would agree, then, would you not, that a large public debt is not of itself inflationary, but rather it is total amount of spending in the economy which may cause inflation?

Answer: A large public debt is not, by itself, inflationary once it has been absorbed into the financial system. The inflationary consequences of the public debt, as of all debt, occur at the time that the deficit expenditures are made (and which are subsequently reflected in debt creation).

While it is true that it is the total amount of spending in the economy which causes inflation, it is important to recognize that credit-based spending is an important and volatile part of the total. Restraints upon credit through Federal Reserve policies are sometimes necessary to limit such credit-based spending. Such restrictions on the volume of such credit may be reflected in higher rates of interest for all borrowers, both private citizens and the U.S. Government.

6. You mentioned that the interest costs on the debt totaled $9 billion in fiscal 1960. I would like to call attention to the fact that in the calendar year 1961, $1,790 million of interest charges on U.S. Government obligations went to the commercial banks. The commercial banks acquired these securities by creating the money. It has always been my contention that the Government does not need private banks to create money to buy its obligations, because the Government's own banks—the Federal Reserve banks—can do this, if it is necessary to create money to place Government securities.

Did the Commission make any recommendation on the question of whether the Federal Reserve should hold more Government obligations and thus have the private commercial banks hold correspondingly less? You know, of course, that the interest payments on any increased holdings by the Federal Reserve banks will go back into the Treasury.

Answer: The Commission did not recommend that the Federal Reserve banks should hold more Government obligations and private commercial banks hold correspondingly less as a means of reducing the interest cost to the Treasury. There are only two ways in which this result could be achieved. First, the Federal Reserve System might buy new issues directly from the Treasury. Second, the Federal Reserve might increase member bank reserve requirements, thus forcing the commercial banks to sell Government securities which the Federal Reserve System could purchase as a means of supplying the additional cash reserves needed by the banks.

The first solution would be entirely unacceptable because of its inflationary character. Each dollar of securities that the Federal Reserve bought directly from the Treasury would release $1 of reserves to the commercial banking system, and these reserves would be used to support a multiple expansion of bank credit. The Federal Reserve would add to its holdings of Government securities but only by sacrificing its ability to prevent inflationary money supply expansion.

The second solution would avoid this inflationary tendency but would be inequitable to the commercial banks. Government securities owned by commercial banks represent the investment of funds left on deposit with the banks. The return earned on these investments compensates the banks for the services they provide to their depositors. If reserve requirements were to be increased and the banks forced to sell part of their holdings of Government securities to the Federal Reserve System in order to obtain the new reserves they would need, the total of customer deposits would be the same as before but the banks would be denied the right to earn a return on a portion of their deposits to offset the cost of servicing these deposits.

7. On page 4, Mr. Freeman, you say that the Commission would not place any priority on debt reduction; rather than changes in the level of the debt should result from policies which have been developed to promote economic stability and growth.

I think I agree with that thought, but we do have certain difficulties. First, in recession times, when the debt increased, there is a great deal of opposition to more debt; we would have a better argument if we could argue that the debt increase is going to be retired later in the recovery period.

But when recovery begins, the Federal Reserve raises interest rates with the effect, as I see it, that the money which might be collected in taxes and used to pay off the debt goes, instead, into the pockets of the moneylenders.

Did the Commission have any recommendation for tying money policy and taxes together in a firm way so that we give higher priority to taxes in boom times than to high-interest rates?

Answer: In chapter 5 of the Commission's report, it is pointed out that discretionary fiscal policy has not been used as effectively in the postwar period as it might have been. Chapter 9 discusses the choice and combination of policy instruments and emphasizes that the instruments used may have differing effects under different circumstances and that the choice of the proper policy mix should be made only after careful appraisal of the particular set of economic circumstances that the combination of policies is intended to influence. On pages 136–137 of the report the Commission specifically recommends a flexible procedure for adjusting tax rates to the business cycle so that tax policy may be a more effective instrument for economic stabilization.

Questions Submitted to, and Answers by, Gaylord A. Freeman, Jr., on the Dealer Market in Federal Government Securities

Mr. Freeman, the Commission concludes, as you report, that the present over-the-counter market in Government securities operates "efficiently" and is not in need of change.

1. What are your criteria of "efficiency" in this respect?

Answer: The Commission's conclusion that the Government securities market operates efficiently is found on page 118 of the report and is stated as follows: "Recent studies have shown that the present over-the-counter market made by the 17 dealers operates efficiently." The Commission did not conduct an independent study of the Government securities market or attempt to establish criteria for measuring efficiency. It relied principally upon the Treasury-Federal Reserve study of the Government securities market published in July 1959, and the "Study of the Dealer Market for Federal Government Securities" published by the Joint Economic Committee in December 1960. These studies, as well as various other materials submitted to the Commission, conclude that the Government securities market is indeed efficient in providing a valuable service to the Government, to the monetary authorities, and to the private financial community.

2. Does your judgment as to "efficiency" pertain to all segments of this market—both for the short- and the long-term issues?

Is it not true that in the longer end of the maturity range, only a very few dealers actually function? In view of this fact, do you nevertheless feel that the market operates efficiently?

Answer: The conclusion that the Government securities market operates efficiently applies to both the short- and long-term segments of the market. In appraising the efficiency of a market, I would judge that it is necessary to weigh the performance of existing institutions against the performance that might be expected from alternative institutions. The observable fact that it is more difficult to trade long-term securities in any volume than it is to trade shorter term securities would appear to me to be related to the greater risk inherent in dealing in long-term securities rather than to the character of the market. Would an alternative form of market organization improve the breadth and depth of the market for longer term securities? I am aware of no suggestion for change that might promise this result. In spite of the often-repeated complaint that the long-term Government securities market is "thin," the total volume of trading in that market exceeds the volume of trading in any other securities market, and the price "spreads" at which bonds are traded is smaller. Both facts suggest an efficient market organization as compared with markets for other types of obligations.

It is probably true that only a few dealers stand ready at all times to make a market in either direction for all of the long-term issues. But most of the dealers are prepared most of the time to make markets in either direction for most issues. Consequently, it is not correct to assume that only a very few dealers represent the entire market in longer term obligations. In portfolio operations for our own bank, we have found that we can rely upon the Government securities dealers to make markets for very large amounts of longer term securities, and our experience suggests that in any such operation we may expect a majority of the dealers to participate.

3. Did the CMC make an independent study of this market—to determine who are the dealers, their legal structure, capital base, means of finance, level of profits, and how they function?

Answer: The Commission did not undertake an independent study of the Government securities market. However, the staff economist who directed research on the debt management section of the report is the author of a forthcoming study of the Government securities market, and his independent research was useful in the Commission's deliberations.

4. What is the degree of concentration in this market? If, as has been reported, the three largest dealers account for something close to half of all the transactions, do you feel that an adequate degree of competition prevails?

Answer: There are no published data on the degree of concentration in the Government securities market. It is known that some of the dealers conduct very large operations and that others operate in Government securities in only a marginal way. But the Commission has no information that would make it possible to judge whether the three largest dealers account for as much of the trading volume as you suggest.

The direct experience of the First National Bank of Chicago confirms the conclusion reached by the independent studies of this market, that a very high degree of competition does prevail. Our customers regularly check our quotations against the quotations of other dealers before entering into a trade. Although our operation is small relative to some of the other dealers, we find that we are able to compete effectively and to get our share of the business in competition with even the largest dealers. As only one bit of evidence of the competition

that prevails in this market, I might point out that the firms that are largest today in terms of trading volume were not among the largest 10 or 15 years ago, and that some of the firms which were most important only a few years ago are now of secondary importance. The history of the market suggests that the most important firms at any time are those that are directed by aggressive entrepreneurs, and that as this type of leadership wanes the firm itself slips back in the race. I find it difficult to believe that any market with such a history and so constituted should not be a model of competition.

5. The CMC report states (at p. 119) that entry into the Treasury securities market is "open." In this connection did you make an inquiry to determine the effect on entry of the Federal Reserve's little-known practice of "recognizing" dealers with whom it will transact business?

Answer: The Commission did not make an independent study to determine the effect on entry into the Government securities market of the procedures used by the Federal Reserve System in determining the dealers with whom it will transact business. It is generally known, however, that "recognition" of dealers is no longer an accurate description of Federal Reserve procedure. Any firm that has set itself up as a dealer in Government securities can trade with the Federal Reserve upon establishing its financial responsibility and its wilingness to make primary markets in Government securities. I have not certain knowledge in the matter, but I believe that inquiry would show that the two new dealers who have begun operations this year have traded with the Federal Reserve from the outset.

The Federal Reserve's practice in this respect is neither more nor less than the conservative practice of any large investor in selecting the security house with which it will do business.I do not believe that it affects entry into the market in any way.

6. In your statement, and in the CMC report, you comment that "dealer-trading profits per dollar of sales are small." But did you determine whether rates of return in this market are? Did you investigate the implications of the findings that dealer profits in 1957 and 1958 (the most recent data generally available) provided extremely high rates of return (see the accompanying page)?

Mr. Freeman, you know, of course, about the great debacle in the bond market in mid-1958, a debacle which comes about by reason of the Federal Reserve reversing its money policy. There were billions of dollars lost in that market in the late summer, and there was a great deal of newspaper talk at the time that the open market dealers took a beating because they were as much surprised by the Federal Reserve's reversal of money policy as anybody.

Later, however, this committee obtained profit and sales data from the 17 open market dealers. Surprisingly enough, we learned that the dealers made more money in 1958 than they had made at any time before in their existence.

For example, we found that in the 10-year period, 1948 through 1957, the dealers' profits for $1 million of gross sales was $298 for the whole 10-year period, but when we add in 1958 and compute the average profits for the 11-year period, we find that their profits jumped to $319 for each $1 million of sales.

Answer: The Commission did not conduct an independent study of dealer profits. In the absence of such a study, I am not in a position to advance an explanation for the size of the dealer profits in 1958 relative to other years. I am confident, however, that a study of the detailed trading data, position data, and profits by months would establish a perfectly reasonable explanation. I might add that the First National Bank's experience as a Government securities dealer suggests that this is not an unusually profitable business; our dealer operation is one of our least profitable functions.

In your question you state that the collapse in the Government bond market in mid-1958 "* * * comes about by reason of the Federal Reserve reversing its money policy." My reading of the record suggests that this statement is not entirely accurate. Prices of Government bonds began to decline in the middle of June, and by the end of July prices of most bonds were three points or more below their mid-June levels. The decline appears to have resulted from market anticipation of a change in policy because of the improving business situation. The record shows that the Federal Reserve System did not begin to move toward less easy money until early August, when margin requirements were increased. Discount rates were then increased later in August and in September, and the first movement toward lower free reserves also came in September.

If my interpretation of the record is correct, it is not accurate to attribute the "debacle" in the Government bond market in mid-1958 to a change in Federal

Reserve policy, since the change came a long while after the price break. Dealers could scarcely have been more or less surprised than others by a change in policy that didn't happen.

7. Did you make any inquiry into the extent to which the dealers, either because of mutual ownership or other facts, "coordinate" their activities in such a way as to reduce their rivalry?

Mr. Freeman, our last observation, and one of perhaps lesser importance, is that the Commission welcomes the publication of new weekly data on the Treasury securities market by the Federal Reserve Bank of New York on behalf of the System and the Treasury.

We would favor, in addition, the publication of additional data on the ownership of the debt.

Answer: The Commission did not inquire into the existence of "coordination" among dealers in the conduct of their operations.

I have not been aware that there was "mutual ownership" of any of the Government security dealer firms (although until recently stock in one of them was owned by banks that also operated dealer departments), and I certainly had not been aware of "coordination" that might tend to reduce rivalry among the dealers. My own firsthand impression, and the conclusion of the various independent studies of the market that have come to my attention, is that rivalry and competition are as fierce in the Government securities market as in any market in the country.

Mr. FREEMAN. Our last observation, and one of perhaps lesser importance, is that the Commission welcomes the publication of new weekly data on the Treasury securities market by the Federal Reserve Bank of New York on behalf of System and the Treasury.

We would favor in addition the publication of additional data on the ownership of the debt.

Senator DOUGLAS. Mr. Freeman, may I interrupt at this point?

Mr. FREEMAN. Yes, sir.

Senator DOUGLAS. This is the direct result of recommendations of this committee.

Mr. FREEMAN. Yes, sir.

Senator DOUGLAS. And I may say that we have had a great deal of inertia on the part of both the Treasury and the Federal Reserve, so once again I want to congratulate this Commission in coming to the same conclusion at which we had arrived, and this is great moral reinforcement for us on this matter.

Mr. FREEMAN. The Commission, widely representative as it is, recognizes that there is a broad diversity of attitudes in relationship to the management of the public debt, and further recognizes that any legislative decisions must be representative of even a wider area of conflicting views, and that as a consequence any policies that are adopted would represent the compromise of the different views.

We also recognize that the area of our knowledge in respect of the management of the debt is still so limited that we are far from precise in our statistical information or in our understanding of the most appropriate policies.

On the other hand, the Commission was convinced that the recommendations which it has made in this area, and which I have had the pleasure of discussing with you briefly this afternoon, would, if they were adopted by the Government, lead to greater efficiency in the administration of the public debt. We hope that the suggestions are of some use to this distinguished committee and to the Congress and that they will facilitate our common efforts to improve the functioning of the American economy, which is the very bulwark for the freedom of all American citizens.

That is everything I have to say, and I thank you very much.
(The prepared statement submitted by Mr. Freeman follows:)

STATEMENT ON DEBT MANAGEMENT AND THE GOVERNMENT SECURITIES MARKET BY GAYLORD A. FREEMAN, JR., MEMBER, COMMISSION ON MONEY AND CREDIT, AND PRESIDENT, THE FIRST NATIONAL BANK OF CHICAGO

I am Gaylord A. Freeman, Jr., a member of the Commission on Money and Credit, and I appear today to present the Commission's views on the subject of "Debt Management."

Mr. Eccles, Mr. Wilde, and Mr. Nathan have already had the opportunity of presenting to you the Commission's recommendations concerning the Federal Reserve System, monetary policy, and fiscal policy. The problems of the public debt and of public debt management are closely linked to all three. Debt management and monetary policy, in particular, have much in common. Both affect economic activity by altering the liquidity of the economy and the level and structure of interest rates.

I should like to discuss first some pertinent facts about the public debt. (See table I.)

There is no completely unambiguous measure of the size of the Federal Government indebtedness. For example, the gross public debt on June 30, 1960, was reported at $287 billion. But of this total, $55 billion was owned by Government trust funds and $27 billion by the Federal Reserve System. It is sometimes useful to look at the debt net of the holdings of Government agencies. Alternatively some people have argued that the debt should include contingent liabilities and guarantees; when he was Budget Director, Mr. Stans estimated that the public debt including such contingent liabilities would total $750 billion. Or the gross debt might be adjusted downward by offsetting the $50 billion or so of financial claims on the private economy held by Government.

For purposes of the CMC study of debt management, as it affects our goals, we have chosen to work with the gross public debt as usually reported, without adjustment either for contingent liabilities or for the claims on others held by the Government. The only adjustment we make is to exclude the roughly $82 billion of public debt owned by U.S. Government agencies and trust funds and by the Federal Reserve banks. While it is all significant, it is the remaining $205 billion of debt which is held by the public that is the most important portion for debt management policies. (See table II.)

Changes in the size and composition of the publicly held debt have a direct effect on the liquidity of private investors. Of the more than $200 billion of Government debt held by the public, over three-fourths is in marketable form; the remainder is largely in nonmarketable issues which are redeemable on demand.

It is hardly necessary to point out to so sophisticated a group as this the great increase in our public debt. A two-sided coin, this debt is substantial liability owed by the Government, but an important asset owned by numerous individuals and corporations. In its shorter maturities it is liquid and very close to money. In longer maturities, it is an investment. Its size influences the money supply. Both its size and maturity schedule influence liquidity. As the Government competes with other borrowers and they with it, the cost of the Government debt is not only influenced by other borrowings, it in time influences the costs of all other debtors.

The size of the public debt and the changes in its size also have other economic significance. In the first place, the size of the debt is a determinant of the interest cost for servicing the debt. During fiscal 1960 interest costs on the debt totaled about $9 billion. Taxes are levied to pay the interest costs, and these taxes have some effect upon the distribution of income. The Commission found, however, that the wide ownership of the debt and the progressive tax system probably prevent the transfer of income from taxpayer to debt-holder from having a significant effect on the distribution of income by income groups. Of course, this transfer of income could have serious effects if the size of the debt and of the interest payment on it were unusually large relative to total national product. But this does not appear to be the case. Interest charges on the debt in 1959 were 1.6 percent of gross national product, which compares with 2.2 percent in 1946, and 1.0 percent in 1939. (See table III.)

1. Although many of the Commissioners desired to see some reduction in the amount of the Government debt, the Commission concluded that none of the difficulties posed by the existing debt are so great as to justify giving priority to a policy of debt reduction if such a policy should interfere with a stabilizing fiscal policy.

Changes in the level of the debt should result from fiscal policies which have been developed to promote economic stability and growth; such changes should not be sought as important objectives in themselves. A gradual reduction in the debt can be expected as a stimulant to sustainable economic growth, but only if combined with other measures for maintaining low levels of unemployment and reasonable price stability.

Most of the problems of public debt management are related to decisions as to the time of financing and the securities to be issued in order to refund outstanding debt or to finance a deficit, or the securities to be retired as a result of a budget surplus. The Commission's principal recommendations on public debt management fall in this area.

2. The Government should not make the ownership of any public debt issues compulsory on the part of any group or groups of investors.

Security reserve requirements have from time to time been urged on grounds that they might contribute to a lower interest cost on the debt or to the simplification of debt management. The Commission found no merit in this reasoning, which would be quite contrary to our concept of economic freedom, and noted further that there would be increased costs on private debt if it were displaced through compulsory holding of public debt. The Commission concluded that the interference with the smooth operation of the money and capital market that would result would more than offset the questionable advantages of compulsory debt holding.

3. Sound debt management requires that we arrest the shortening of the outstanding public marketable debt which has occurred since the end of World War II. The Treasury should pursue a program which, over time, would lead to a more balanced and sustainable maturity structure for the debt.

Between 1946 and 1960, the average maturity of the marketable debt in the hands of the public shortened by more than one-half. Further shortening of the debt means increased liquidity in the economy, and a large volume of a short-term debt may generate more active use of these balances just at a time when monetary policy is attempting to restrict the money supply. This interference with the objectives of monetary policy should be avoided in the future.

4. Once the shortening of the debt structure is arrested, management of the marketable debt can and should make some contribution to stabilizing the level of economic activity. However, the primary responsibilty for achieving this objective must be borne by monetary and fiscal policies.

Countercyclical debt management would entail lengthening the debt structure during an inflation because this tends to be restrictive, and shortening the debt structure during a recession because this tends to be expansive. In a boom, the budget surplus should be used to retire short-term debt, and new borrowings in recession should be at short term. There are, however, limits upon aggresive pursuit of a countercyclical debt management policy. Such a policy would prevent the Treasury from taking advantage in refunding operations of low long-term rates during recessions, and thus tend to add to the interest cost of the debt. Also, the market's absorptive capacity places limits upon the amount of debt lengthening that might be done in a boom. While the Commission recognizes a role for countercyclical debt management, its findings suggest that this role might be rather limited.

5. The development of a balanced and sustained maturity structure for the debt will require some rearranging of the publicly held debt, including some movement of the debt into longer maturity categories. The transition to a more balanced structure should be made during periods of buoyant economic activity.

Because of the restrictive effects of debt lengthening, this timing of the transition process is in keeping with our basic objectives of low unemployment, price level stability, and growth.

6. The Treasury should take measures to expand the proportion of the public debt in the form of savings bonds on terms which are competitive with yields of suitable alternative forms of investments for small investors.

Although the flexible use of monetary policy has posed problems in adjusting yields on savings bonds to fluctuating market rates of interest, the Commission concludes that the value of the savings bonds justifies a more active role for them. Not only does the program encourage thrift among small investors, but it might enable the Treasury to achieve its basic debt management objective at

lower interest cost than would be required on marketable securities. The Commission is opposed, however, to the introduction of constant-purchasing-power savings bonds as a means of encouraging sales because of the inflationary bias inherent in such an innovation, and because of the unsuccessful experience of other countries that have experimented with "indexing" of financial assets.

7. The Commission does not favor consolidating the Treasury and the Federal Reserve as a means of coordinating debt management and monetary policy.

Monetary and debt management policies must be formulated and executed in close relationship because of the complementary influence they have upon the economy through the level and structure of interest rates and the availability of loanable funds. Unless policies are coordinated, they may tend to counteract each other. It would be possible to achieve the necessary coordination by making the Federal Reserve subordinate to the Treasury. However, the fact that the Treasury is the largest single borrower in the market, and would thus find itself torn by a conflict between its interest as a borrower and its responsibility for monetary policy, makes this undesirable. Alternatively, the responsibility for Treasury debt management might be delegated to the Federal Reserve; but it is unrealistic to believe that any administration would acquiesce in the transfer of the borrowing power of the Government to even a quasi-independent agency. The need for coordination was covered by Mr. Frazar Wilde's testimony yesterday.

8. The range of discretionary debt management authority exercised by the executive branch should be broadened. Specifically, the debt ceiling and the interest rate ceiling should be eliminated.

The debt ceiling has been defended as an inducement to fiscal responsibility and a curb on spending, but it has not had this effect. The Treasury cannot control the amount of debt; it must finance the programs and appropriations voted by Congress, and to do so the Treasury has sometimes been driven into devious and expensive devices to stay within the debt ceiling. The debt ceiling has had little demonstrable effect on the Congress. Thus it has been an impediment to sound debt management without having any apparent offsetting advantage.

Similarly, the 4¼ percent interest rate ceiling on Treasury bonds is defended as a means of holding down the interest cost of the Federal debt, but it apparently has had the opposite effect by forcing the Treasury into what at times has proved to be very expensive financing in short- or intermediate-term securities not governed by the ceiling.

If the Treasury is to finance the public debt, it must pay competitive rates of interest in the maturities it has selected in line with the broad policy objective it is pursuing. While the recent opinion by the Attorney General has apparently lessened the limiting potential of the interest rate ceiling, it would, nonetheless, be desirable to remove the ceiling from the law. In order to encourage reofferings to space the debt, it would be desirable to change a technical provision in the Internal Revenue Code limiting the allowance of discount on the price of original issues, which may be claimed as capital gains, to one-fourth of one point for each year of the life of the security. The tax treatment allowed on reofferings of additional amounts of specific issues should be the same as that for outstanding securities. The loss of revenue to the Treasury would be negilible.

9. The Treasury should continue to experiment with the various refunding techniques as a means of achieving debt extension.

When securities are refunded at maturity, they often have shifted into the hands of short-term investors who are interested only in short-term reinvestment, even though the maturing issues might originally have been of longer term. In order to retain the intermediates and long-term funds already invested in Government securities, with minimum impact on the market, it is more effective to offer holders a reinvestment option before their investment has moved into the short-maturity range.

10. The Treasury should continue to experiment with the use of the auction technique.

Sale of securities at auction places reliance upon the market to determine the proper price, and lessens the Treasury's responsibility for pricing decisions. This technique might be used over a wider range of maturities than at present.

11. Although the Commission does not favor broad authority for margins for the secondary market, it does recommend that minimum margins, such as the 5-percent margin now set by the New York Stock Exchange and the Comptroller of the Currency, be applied by various supervisory authorities to presently nonregulated lenders, including nonfinancial corporations.

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The findings of the Treasury-Federal Reserve study of market behavior in 1958 suggest the need for somewhat greater regulation of the margins on Government securities. The lenders not presently regulated in one form or another include nonnational banks, brokers and dealers not members of the New York Exchange, and nonfinancial corporations.

12. Because the present market for Treasury securities is the outgrowth of dealer competition to meet the needs of market participants, the Commission made no recommendations in regard to market structure.

Recent studies have shown that the present over-the-counter market made by the 17 dealers operates efficiently. Active competition prevails, and dealer trading profits per dollar of sales are small. Fewer dealers operate in the long-term markets, and price spreads are wider than in the short-term market. However, this is the result of the structure of the debt itself and of the inherently greater risk of trading in long-term securities. The Commission studied the question of dealer financing facilities. It does not favor direct access to the Federal Reserve by dealers on their own initiative because this procedure may conflict with an effective monetary policy. Moreover, it has confidence that the Federal Reserve will take appropriate action to make funds available in periods of stress.

13. The Commission welcomes the publication of new weekly data on the Treasury securities market by the Federal Reserve Bank of New York on behalf of the System and the Treasury.

The publication of this data should improve public understanding of the Treasury securities market and assist investors, analysts, and students. The Commission also favors the publication of additional data on the ownership of the debt.

The Commission, widely representative as it is, recognizes that there are varying views on questions of debt management. A legislative decision must, as does the report of the Commission, represent a compromise of these differing views. The circle of our knowledge about debt management has not yet expanded sufficiently to give us the absolute statistical precision and unquestioned accuracy which we would all wish to have.

The Commission does believe that these recommendations, which I have had the privilege to present today, would, if adopted, significantly improve our performance in managing the Federal debt. That, of course, is what we have sought to accomplish through many months of work. I hope that our report will be of assistance to this distinguished committee in our common efforts to improve the functioning of the American economy as a bulwark for the welfare and freedom of us all.

TABLE I

Direct and Guaranteed Debt of the Federal Government

June 30, 1960

(Billions of Dollars)

	U.S. Gov't. Investment Accounts & Fed. Res. Banks	Owned by the Public	Total
Public Issues:			
Marketable Securities	$34.4	$149.6	$184.0
Nonmarketable Bonds			
Convertible Bonds	2.5	3.8	6.3
Savings and other	0.1	48.1	48.2
Total Public Issues	37.0	201.5	238.5
Special Issues	44.9		44.9
Total Interest-Bearing Debt	81.9	201.5	283.4
Matured and Noninterest-Bearing		3.1	3.1
Total Gross Debt	81.9	204.6	286.5

TABLE II

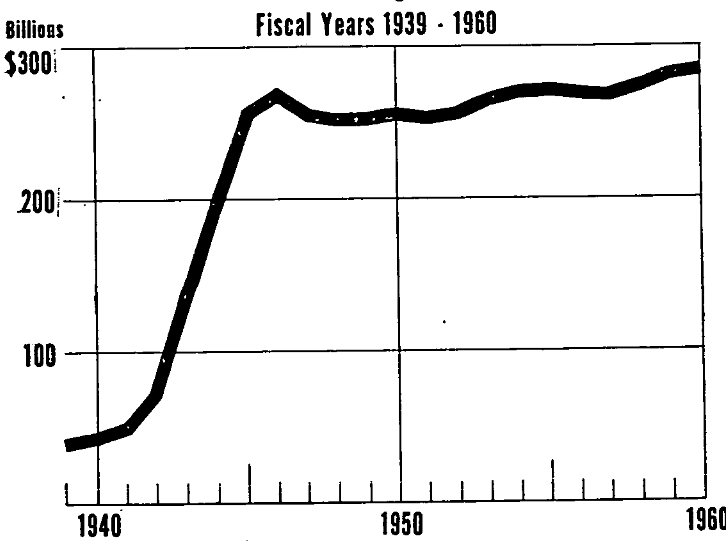
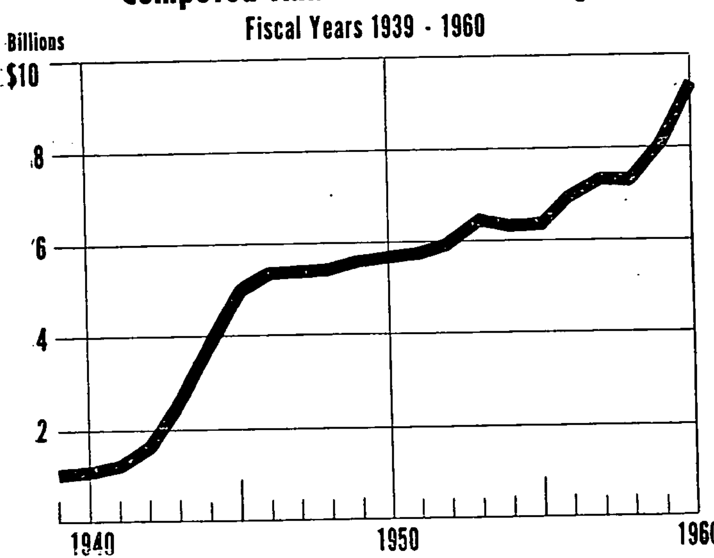


TABLE III



Chairman PATMAN. Senator Douglas.

Senator DOUGLAS. Mr. Chairman, the First National Bank of Chicago has always had a very able and public-spirited leadership, and I think Mr. Freeman's appearance this afternoon indicates that this tradition is being continued and enhanced.

Mr. FREEMAN. Thank you very much.

Senator DOUGLAS. I would just like to ask one question, and that is on the refunding issue covered in your written statement.

We also suggested this to the Treasury as one of the forms which we urged them to adopt. But I had always thought this refunding would be used to substitute lower interest rates for higher interest rates; that if an issue had been floated at a time when interest rates were high, and subsequently it developed that interest rates fell, then we could save on interest rate by floating a new issue at a lower rate.

Then by process of exchange or those who did not want to accept the new issue by sale, that the net interest burden could be reduced.

I was somewhat startled, therefore, when last year the Eisenhower administration refunded a lower interest rate issue with a higher interest rate issue, and the difference in duration was not great, so that they did not lengthen the debt appreciably.

The lower interest rate was not going to mature for some years. The new issue was only, I think, 2 or 3 years longer than the old issue, but the interest rate was appreciably higher.

As I say, that seemed to me to be an extraordinary performance. I criticized it, but it was discredited as a political attack in the heat and hurly-burly of the campaign.

Is it not generally true that the refunding principle should be used to lower the total burden of interest charges?

Mr. FREEMAN. If we were looking on it solely from the point of view of the Treasury, I would think ordinarily we would say yes.

I would think, however, that there might be a time when it would be wise to refund even at a higher rate. Let us say that a 30-year bond is within 4 or 5 years of maturity and we are in a highly inflationary period. I can imagine the Treasury and the Federal Reserve both saying it is desirable as an act of monetary policy (if you thought this boom was going to go on for another 3 or 4 years) to extend this debt now while it is still in the hands of long-term investors, even though to do so would require offering a higher rate. They might feel that the countercyclical effect of the removal of this asset before it became more liquid, warranted the paying of a higher rate. I can imagine that that might be so.

Senator DOUGLAS. Of course during this time we were not troubled with a hectic boom.

Mr. FREEMAN. I find my self not sufficiently familiar with the circumstances at the time to comment intelligently.

Chairman PATMAN. Mrs. Griffiths.

Representative GRIFFITHS. I have no questions, but I would like to commend you for your statement.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. I have asked some questions in the course of the presentation. I would just like to ask one further question.

Mr. Freeman, I am a little bit concerned about the Commission's failure to be more specific and definite in indicating just how the Treasury would lengthen the debt.

Of course, we all recognize as the previous administration did, the advantages of lengthening the debt. But the Commission statement is such a modest and moderate one. Is this one of those

things we are going to protest meekly and timidly, but then in spite of our protest find our debt getting shorter and shorter and shorter with the liquidity complication involved, and also the other problems involved too. I wonder if there is not some kind of specific recommendations that go further than you have gone so far that we could follow.

Mr. FREEMAN. There isn't any recommendation of the Commission that would go further. I think the Commission perhaps was a little temperate in what it said on this score because there is a conflict, not between members but within each member's own mind, as to the desirability on the one hand of using debt maangement as a countercyclical tool after you once get the debt properly spaced, and the feeling that perhaps meanwhile the time to extend the debt is when you can extend it.

The problem there is, a time of relatively little business activity, when interest rates are low and there is plenty of investment money available, is perhaps the best time to extend the debt, despite the fact that this would tend to slow up the economy a little bit, because you have to extend the debt when you can.

Once you have got it out there, you have a little more discretion, and you can use your debt management as a countercyclical tool. But it takes pretty severe surgery to get it out there.

Senator PROXMIRE. Can't you do it by compensating action by the Federal Reserve? I am not talking about the Federal Reserve being owned.

I agree with you 100 percent on your recommendations here, of course, as does everybody else, but it seems to me that there could be Federal Reserve action to compensate very easily for this kind of thing during this kind of period, perhaps not very easily but it could compensate for it.

Mr. FREEMAN. That is my personal conviction, but the Commission did not precisely say this.

But I do believe that to get it out there you have to extend it during easy times when the money is available, and interest rates are reasonable. It takes a certain amount of courage to extend any really substantial amounts of the debt and you could be much more confident of your ability to do so in an easy money period. In such a period I think you could find a market for a substantial amount of long-term debt. I think by making the slight change in the tax law which the Commission recommends, you could reopen that issue from time to time, or several issues from time to time, and that you could get the debt extended further, yes, sir.

Senator PROXMIRE. In coordination between the Federal Reserve——

Mr. FREEMAN. Yes——

Senator DOUGLAS. Would the Senator yield?

Senator PROXMIRE. I yield.

Senator DOUGLAS. I put in the record a few days ago 13 points on which the Commission had agreed in its recommendations which the majority of this committee made in its "Report on Employment, Growth, and Price Levels."

You now add a 14th, namely, that the primary consideration should be the interest rate of the debt, and that the time to issue the long-

term securities and spread out the length of the debt is during a recession or at least a nonboom period when money is plentiful, credit is plentiful, and interest rates are lower.

And so I am discovering constantly new points of agreement. This is 14—I think the 15th one, as a matter of fact. And so you have rehabilitated the reputation of this committee, Mr. Freeman.

Mr. FREEMAN. We would feel great pride if that were so.

Senator PROXMIRE. Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Freeman, I have heard what you just said to Senator Proxmire. I want to say a Daniel come to justice.

I was going to say that your presentation was magnificent. Now that you have given your own views on what has seemed to me to be the one weak point of the Commission's recommendations, I feel entirely happy about your presentation.

Let me spell this out just a little. In your testimony earlier this afternoon, you did say, as the Commission did, that all are agreed that we ought to lengthen the debt, and the time to do it, said the Commission and said you earlier today, was when there is buoyant economic activity.

Now I am delighted that speaking solely for yourself, and we understand that you are not now echoing the Commission report, you believe that a nonbuoyant time of activity, very much like, for example, August 1961, is a good time to do this.

Mr. FREEMAN. I think so, yes, I do.

Representative REUSS. I am delighted to hear you say that. It happens to agree with what I have been urging for some time.

I want to question you for a moment on the point Senator Proxmire made about the participation of the Federal Reserve. I take it that the reason the Commission on Money and Credit made the recommendation to wait for a boom before lengthening the debt, was the fear that if you start issuing long-terms at a time like the present when we have 7 percent of our labor force unemployed, you sop up long-term capital that ought to go into private investment to get us moving forward.

Mr. FREEMAN. That is one argument. The other argument would be if you put it into 1-year maturities instead of 30-year maturities, it could be again liquidated and converted into spending, consumer spending and other spending where, if it gets in the 30-year category, it is not likely to be sold and pumped into the stream; yes, sir.

Representative REUSS. I have felt that that argument is more apparent than real, and that it would be an excellent idea for the Treasury now to start issuing a much higher percentage of long-terms than it has.

It did do a little a month or two ago and it was quite remarkably successful. I thought it would be.

However, as we all know, every month billions and billions of short-terms come due, and it would be an easy mechanical thing to say that, instead of issuing even more short-terms, because we are now getting into a budget deficit period, we are going to enlarge this a bit with some long-terms.

Then to get to Senator Proxmire's point, the Federal Reserve has a tiny fraction of its $27 billion portfolio in long-terms, that is secu-

rities with more than 5 years to go. The Fed could quite readily shift a portion of its short-term portfolio into longer terms.

If it be said that this is going to produce a great disequilibrium in short-term versus long-term interest rates, I would reply that the present yield on Treasury bills is around 2.2 percent. The present yield on Treasury bonds is around 4 percent, almost double.

Therefore I think that you would have a long way to go in thinning the Treasury's portfolio of short-terms and thickening its portfolio of long-terms before you got the long-term rate so chasing the tail of the short-term rate that you produced market disequilibrium.

It might not be necessary for the Fed to do any pronounced shifting at all. You can only tell, I suppose, by trying more aggressively now to lengthen the overall maturities of marketable Federal debt.

I have asked you to be patient while I got this all out, because I wanted to be sure that you understood what was in my mind. Have I said anything which disturbs you?

Mr. FREEMAN. Yes. It would be reasonable to suggest that although the Federal Reserve might not want to extend its debt in time of boom, electing to keep the Treasury—and other borrowers—under a little bit of pressure to sell securities on the market at that time and hence have a restrictive influence on the economy, that nevertheless the Fed could extend its debt at a time like this when it doesn't intend to be restrictive.

I suppose, and let me emphasize that I do not know, I suppose the Fed says to itself, "We won't extend our debt even in easy times when there is no need for a restrictive monetary policy. We want to keep it short, so that we will have that much more of a club over the Treasury. We will have that much more coming due next year and the year after, if that does happen to be a time when we want to exert a restrictive monetary policy."

This may be what runs through the minds of the Federal Reserve.

Representative REUSS. Do you think though, that it should run through the mind of any rational man that the Fed needs to keep 95 percent of its $27 billion portfolio in short-terms for such a purpose?

If I were advocating that the Federal Reserve get rid of all its short-terms and buy $27 billion of long-terms, of course that would be an absurd proposition. I am doing nothing of the sort. I am simply saying instead of having 5 percent in long-terms, what would be harmful with having 10 percent, let's say?

Mr. FREEMAN. I am not a spokesman for the Federal Reserve.

Representative REUSS. I appreciate that.

Mr. FREEMAN. And I am not a properly informed scholar in this esoteric field, but I would suppose that they might say "by keeping all of our maturities short, or doing nothing to lengthen them we, first, tend to reduce the total cost, for what importance that has, and it doesn't have much because what the Fed makes in the way of interest comes back to the Treasury anyway, but we tend to reduce the immediate out-of-pocket cost because we hold the"——

Representative REUSS. I think you have already answered that when you say it is out of one pocket into the other.

Mr. FREEMAN. And, "secondly, should we extend any amount of our debt into the long maturities, we would not have that coming

due to the same extent during that period of boom when we might like to exert a little influence on the Treasury." Again let me say that I have not discussed this with the Fed and my attempted explanation is mere conjecture on my part. In fact this explanation doesn't even satisfy me for the Fed doesn't have to wait for refundings to exercise its monetary policy. It is buying or selling every day and can create or sop up reserves as it wishes—and in such maturities as it wishes without waiting for refundings. Thus an accurate answer is "I don't know."

Representative REUSS. I realize you are speaking not for the Fed and not for the Commission but just for yourself.

Don't you think the national interest would be best served if the Fed, if it does have such point of view, should promptly purge itself of it?

Mr. FREEMAN. I am not sure, Congressman. I think there are times when the Federal Reserve feels that it is a voice in the wilderness, that it is the principle bulwark against inflation, and that it must use all of the tools it can.

Though no one ever says that they are for inflation, everyone in society wants either higher profits or higher wages or higher salaries, and to the extent that these three increase more rapidly than productivity, higher prices or inflation are certain to come.

Hence, there is always a little political bias toward expansionary or inflationary policies, and the Federal Reserve, if it is to exert the maximum influence which it can—which will probably not be enough to overcome the political pressure—should use every tool at its disposal. I can imagine that this would be what would be running through their minds.

Representative REUSS. I am not sure I really understand the point you are making, that the Fed would want to keep almost all of its securities in very short term in order to be able to bring anti-inflationary pressure to bear in a boom period. Would you perhaps run through that again for me?

Mr. FREEMAN. The Treasury goes to the Federal Reserve and says, "Look, you have some bonds that are coming due in September that were 10-year bonds to begin with. Won't you take a 10-year bond in place of those and get this part of the debt off our necks, because if we want to put out a 5-year issue now, we have got to sell to the public that much of your maturing debt that you aren't going to exchange into a 5-year bond. If you don't go along we have got to go out to the public and sell this additional debt if we want to get it extended."

And although I do not know, it may be that the Fed says to itself in advance, "That is fine. We want to put them under that discipline of having to sell the additional amount to the public because this will have the effect of, (*a*), raising the interest rate which will tend to have a restrictive influence on the economy, and (*b*) reducing the amount of investment money available to other borrowers, whose borrowing and spending would exert additional inflationary forces."

It is possible that this is what runs through the mind of the Federal Reserve.

Representative REUSS. Now that you have explained what you are saying, you are referring to a time of boom and buoyancy, are you not?

Mr. FREEMAN. Yes.

Representative REUSS. This is when this would happen?

Mr. FREEMAN. That is right.

Representative REUSS. And if that time comes, there is nothing to stop the Fed from shortening its portfolio. As it can lengthen it, it can shorten it in the open market.

Mr. FREEMAN. You mean just through the open market?

Representative REUSS. Yes.

Mr. FREEMAN. Yes, that is right, but we are really talking about larger amounts in longer maturities than they have heretofore been engaged in buying and selling in the open market. So the——

Representative REUSS. And, of course, with its $27 billion portfolio, there are tremendous sums that do change hands.

Mr. FREEMAN. That is right.

Representative REUSS. Most have been in the short end because that is all they had.

Mr. FREEMAN. That is right.

Representative REUSS. And, of course, for monetary expansion and contraction purposes, you do need bills or very short securities, because you want to make those ins and outs with the least effect.

Mr. FREEMAN. Exerting their influence in delicate proportions, that is right.

Representative REUSS. So nobody is suggesting that the Fed should divest itself of all its short-term securities.

Mr. FREEMAN. No. I may be wrong in my analysis of how the Fed would answer your question. I have had the feeling that they would like to have this pressure on the Treasury as a kind of discipline, and that they would not want to get an appreciable amount of their debt out into long maturities now because then that discipline would be weakened just that much if, 2 years from now, we were again in a boom, or 6 months from now, which is very possible.

Representative REUSS. Then, to wrap this point up, I ask you to answer it speaking for yourself and not try to put yourself into the Fed's shoes, and I gather your personal recommendations for debt management are, one, that we should attempt to lengthen the debt, two, that we should not wait until a time of boom or buoyancy to do this for a variety of reasons including, if you wait, you may never do it even then, but that we should attempt to do it at times of recession or lesser buoyancy. And, third, that the Fed, which has plenty of room to shift its portfolio in a longer direction, has a role to play in this, to the extent that its failure to play any role might cause recession prolonging.

Mr. FREEMAN. I certainly agree with your first two points as you stated them.

I think I should add, both on the part of the Commission and on my own conviction, that once we had the debt extended and a reasonable spacing of maturities through the future, that from then on it would be possible and entirely desirable to confine changes in the maturities of the debt to those which would be helpful in countercyclical policies.

Representative REUSS. Yes, that is an excellent point with which I certainly should agree. Thank you very much.

Chairman PATMAN. Thank you, sir.

We have another witness, Prof. Warren L. Smith, of the University of Michigan.

Senator DOUGLAS. Before Mr. Smith takes the stand, may I say in my overeagerness to claim agreement between the Commission and ourselves, I ascribed an agreement between the Commission and the proper time to lengthen the debt. I now realize that this is simply an agreement with Mr. Freeman and not an agreement with the Commission.

Chairman PATMAN. Professor Smith, you have rendered very fine services to the committee in the past, which we do not forget. We are glad to have you, and you may proceed in your own way, sir.

STATEMENT OF WARREN L. SMITH, PROFESSOR, UNIVERSITY OF MICHIGAN

Mr. SMITH. I have a statement here that I will run through.

Chairman PATMAN. In the beginning may I have this understanding. The House is considering the foreign aid bill under the 5-minute rule. The House Members are likely to have to leave at any time to vote on different amendments that come up.

For that reason I would like to have an understanding that any of us may file questions with the reporter which you will see when our transcript is delivered to you for correction, with the understanding that you will answer them for us please.

Mr. SMITH. Right.

Mr. SMITH. Before I talk specifically about the Commission chapter on public debt and debt management, I would like to say that there is a great deal in the Commission's report in general with which I find myself in agreement.

I believe there are many fine recommendations in the report which I hope will receive the attention they deserve, both from the administration and from the Congress.

But I do have one major criticism of the report, which is unrelated to debt management. I believe it fails to face up squarely to the problems arising out of the exercise of market power in the fixing of wages and prices.

It is my opinion that we are faced with a serious conflict between the objectives of full employment, stable prices, and an adequate rate of economic growth, and that it is a conflict which cannot be adequately dealt with by the measures such as increasing labor mobility, enforcing the antitrust laws more vigorously, lowering tariffs to increase foreign competition, and the various other suggestions that the Commission makes in chapter 2 of its report.

This conflict seems to me to be our most serious domestic economic problem, and I feel that the impact and effectiveness of the report is somewhat weakened by the rather cursory manner in which it deals with this particular problem.

Senator PROXMIRE. Mr. Chairman, before he leaves that particular observation, if it is permissible, do you have in mind monetary policies, because, as I understand it, this is a report primarily on money and credit, and the responsibility of the Commission is a monetary responsibility, although it deals with fiscal policy in one chapter.

Did you feel that there might be recommendations with regard to managing the money supply?

Mr. SMITH. No.

I must say that I feel that this is a problem that cannot be solved by simply monetary and fiscal devices, and I do not think it can be solved by these other measures either unless we can devise new ways to bring the antitrust laws to bear on this particular set of problems, for example, and I do not think anybody has suggested up to now an effective way in which this can be done.

When the Commission chose to deal with this set of problems, it seems to me that it had an obligation to face them squarely and recognize their seriousness, and, in my judgment, it did not do that.

Senator PROXMIRE. Do you have in mind the kind of proposal that Congressman Reuss and Senator Clark made a couple of years ago that there be an opportunity for Congress to pass on substantial increases in wages?

Mr. SMITH. I would tend to favor some kind of commission with the responsibility of representing the public interest in key wage-price negotiations. I would not want to try to specify what the criteria ought to be, because I think they would simply have to be established on the basis of experience.

Either that, or else we have to face the problem and admit that we are not willing to take the measures that will permit us to reconcile full employment and inflation and try to judge as best we can the trade-off that exists between the level of unemployment we have to accept and the rate of inflation that goes with it, and come to a decision as to what we are willing to accept in this area, rather than simply trying to convince ourselves that the objectives are consistent with each other. Actually, there is even a strand of thought in the Commission report, it seems to me, that the objectives are not only consistent with each other but that you have to achieve one in order effectively to achieve the other.

I am in favor of all of the suggestions that the Commission makes, and I will admit that, for example, efforts to increase the mobility of labor might do a little bit to help deal with this problem, and would be desirable in any case on other grounds, but I think the conflict between price stability and full employment is just too deep seated and serious to yield to such measures as are suggested.

Senator PROXMIRE. Let me just conclude on this by saying that I agree with you very, very much, and I would be delighted if you could call to my attention any study, any information, any thought that you have on this particular problem. It is enormously serious, although I can see why, at least in my judgment, it is not a responsibility of this particular Commission.

Mr. SMITH. In a sense that is true. My only point is that the Commission did choose to discuss this particular problem and, having made that decision, should have admitted the seriousness of the situation.

Coming to the debt, the chief burden imposed on the economy by the existing Federal debt is the possible disincentive effects of the taxes that are needed to offset the inflationary potential of the interest payments that have to be made on the debt, and also the possible restrictions on the freedom of action of the Federal Reserve that the debt may impose in the following of a flexible monetary policy.

The Commission concludes that these problems are not sufficiently serious to justify giving high priority or, as a matter of fact, any priority, to a policy of debt retirement as an end in itself.

Rather, its conclusion is that we should select the conbination of tax, expenditure, and monetary policies that are most conducive to stability and growth, with the change in the size of the public debt being a resultant of these policies. The report also suggest that a budget surplus is an addition to national saving, and that it may be desirable to have budget surpluses whenever their use to retire debt, perhaps supplemented by other measures to ease money and by incentive taxation, will result in an increase in investment and help to stimulate a high rate of growth, without reducing aggregate demand below levels consistent with high employment.

This view of the problem of monetary-fiscal mix and of the public debt is one that a good many economists have been suggesting for several years, and, in my opinion, it is the proper perspective in which to view the public debt and the problems of monetary and fiscal policy, and I am really delighted to see that the Commission has accepted this view.

Coming next to debt management policy, the Commission draws a distinction, which I like to draw myself and which I believe is useful, between the stock of debt in existence at any particular time and its effects as an automatic stabilizer or destabilizer on the economy, and, on the other hand, the economic effects produced by marginal changes in the composition of the debt.

At times when the Federal Reserve is following a restrictive policy, my studies of these problems that transfers of Treasury securities serve as an instrument by which funds are transmitted from economic units that have excess cash balances to units desiring more funds to spend or to lend, and that these transmissions of funds tend to raise the velocity of circulation of money and to offset part of the effects of a restrictive monetary policy.

In view of the fact that short-term securities are subject to less price variation and to less market frictions in the process of being transferred from one person to another than are exhibited by longer term debt instruments, a debt consisting largely of long-term securities is more likely to be conducive to effective monetary policy than is a debt structure that is composed predominantly of short-term securities.

The Commission recognizes this and recommends that an effort be made to arrest the shortening of the debt maturities which has occurred in recent years.

I agree with the Commission that it would be desirable to lengthen debt maturities in the interests of achieving a financial structure that is compatible with more effective monetary controls. However, when it comes to the question of the timing of the debt operations designed to produce the desired changes in the debt structure, I part company with the Commission's recommendations, although I must say that in his testimony this afternoon Mr. Freeman comes considerably closer to my view about how the timing of debt operations should be carried out than does the Commission report itself.

The report suggests that the flotations of long-term securities needed to achieve a substantial lengthening of the debt, in the first instance, be carried out at a time when economic conditions are such that a restrictive policy is called for, and that once a better debt structure has been achieved, debt management should be conducted in an

orthodox contracyclical fashion, with emphasis on the shortening of debt maturities in recessions and on the lengthening of maturities in periods of inflation.

According to my definition, debt management includes all actions which affect the composition of the publicly held portion of the debt; that is, the debt outside the Federal Reserve's portfolio and outside the Treasury investment accounts. And every debt management operation then becomes simply a swap—that is, a sale of one kind of security and the use of the funds to purchase another kind of security.

Operations of this kind tend to produce changes in the structure of interest rates, and also in the composition of the public's stock of liquid assets.

For example, an operation lengthening the maturity of the debt consists essentially of a sale of longer term securities and use of the proceeds to retire short-term debt.

Such an operation would have some tendency to raise long-term interest rates, and to lower short-term interest rates, and it would substitute in the public's portfolios a less liquid asset for a more liquid asset, without, I might add, changing the nominal value of the total stock of liquid assets held by the public, changes in the size of this stock being determined by the size of the Government's budget deficit or surplus.

Now, from everything that I know about what economists have managed to find out about the impact of financial factors on the level of economic activity and on the level of spending on goods and services, there is, it seems to me, very little evidence that an operation of this kind would be very important.

You push up the long-term rate of interest. This tends to depress some kinds of expenditures. You push down the short-term rate of interest. This tends to encourage some kinds of expenditures.

I must say we do not any of us know very much about precisely what expenditures will be affected or how much in either case. But everything we do know about it—indeed the very fact that we do not know more than we do—suggests that factors of this kind do not have terribly important effects on expenditures.

Nor do we have much evidence that changes in the stock of liquid assets held by the public are a major factor affecting spending decisions, and I might emphasize that debt management operations do not affect the size of the stock of liquid assets. They merely affect the composition of that stock.

In other words, what I am trying to say is that debt management is a second order kind of operation as compared with monetary policy or with fiscal policy.

That is, it pushes one thing up and another thing down, and the effect is a net effect of the changes in these two factors.

Senator DOUGLAS. The Commission admits that, does it not, Mr. Smith?

Mr. SMITH. Yes, but I would put more emphasis than the Commission does on the weak effects, that, as far as we know, debt management operations have on the economy.

The Commission admits that the effects are not terribly strong but it still emphasizes, to some extent, the need for countercyclical debt management policy.

Now, the factors I have just mentioned suggest to me that a policy of countercyclical debt management of the sort suggested by the Commission report would accomplish very little in the way of economic stabilization, and, surely, it would not accomplish anything that could not rather easily be acomplished by a somewhat more vigorous monetary policy.

On the other hand, the concentration of debt-lengthening operations in periods of boom and inflation, when money is tight and interest rates are high, would, I would certainly expect, have a tendency to increase interest costs to the Treasury substantially.

Now, the dynamics of the process of minimizing interest costs to the Treasury are very complicated. You cannot look at it merely in terms of which market is the cheapest one in which to borrow at the particular moment. You have to look ahead and consider what the market is going to look like at the time the securities you issue mature and you have to reborrow.

But in spite of the complexity, it seems fairly clear that if you want to keep interest costs down, such debt lengthening as you do choose to carry out should be concentrated in periods of low-interest rates in order to give the Treasury the benefit of these low-interest rates for the maximum time period into the future.

In practice, what I think would happen if the Treasury were to adopt the countercyclical approach to debt management recommended by the Commission is that it would find it both so costly and so difficult to lengthen the debt in boom periods—difficult due to the fact that everybody else would be trying to get into the long-term market at the same time—that it would not press the efforts to extend the debt very vigorously or successfully.

On the other hand, if the countercyclical theory of debt management were adopted by the Treasury, the authorities would have a tendency to view it as improper in principle to lengthen the debt in periods of recession.

The result of all this would be that debt maturities necessarily would continue to shorten. You would not extend the debt in boom times because it was too expensive and difficult to do, and you would not do it in recession periods because it would be against your principles, and the result would be a continuous shortening of debt maturities.

It seems to me that this is exactly what happened in the last administration in the early stages when the importance of countercyclical debt management was emphasized. The authorities found it too difficult and expensive to market long-term securities in booms, and it was against their principles to do it in recessions, and the result was that the debt continued to shorten.

Now, my view is that the composition of the debt in existence at any time is more important than the timing of the marginal changes that are made in the debt.

For that reason, I would suggest that in the interest of keeping down the Treasury's interest cost, which I think is a matter of some importance, and as a matter of practical feasibility, the Treasury should put some emphasis on debt lengthening during periods of recession and low interest rates.

Such a policy would not be, it seems to me, entirely lacking in countercyclical benefits, because by driving down short-term open market interest rates during recessions, it might have some tendency to encourage banks to expand their loans instead of their short-term investments, a result that would be conducive to recovery.

And if the debt lengthening operations should prove to have undesirable effects, they could quite readily be counteracted by a somewhat easier monetary policy.

I would like to comment at this point on a couple of things that were said in the discussion in connection with Mr. Freeman's presentation.

I must say that right now I would be rather dubious about a vigorous policy of debt lengthening for a special reason. As I interpret Federal Reserve policy, since the beginning of 1961, it seems to me that it has been conducted with the objective of keeping the short-term interest rate from falling below a range of somewhere around 2 to 2½ percent, typically 2¼ percent, for the reason that the Federal Reserve wanted to avoid encouraging a renewal of the outflow of short-term capital abroad.

So that the Federal Reserve has been operating monetary policy within the limits of a constraint imposed by a desire to keep the short-term rate of interest from falling too low.

It seems to me that as long as that constraint continues to prevail—and if we continue to view the balance-of-payments problem the way we have, I expect it to continue and possibly even get more difficult now that the British have raised the discount rate, and short-term interest rates abroad are likely to rise—if we start lengthening the debt and this drives up the long-term rate, we cannot compensate for it by a generally easier monetary policy to keep the general level of interest rates from rising.

Long-term borrowing will have some tendency to raise the long-term rate and to push up the general level of rates as long as we continue to peg the short rate in the neighborhood of 2¼ percent.

As a matter of fact, I do not believe that we can continue to conduct an effective, flexible monetary policy in the interest of domestic stability unless we can get away from this necessity of pegging the short-term interest rate at this level. That is, we must devise some other way of dealing with our balance-of-payments problem in order to recapture flexibility in general monetary controls.

Senator DOUGLAS. That raises a collateral question which has bearing upon this.

If the 25-percent gold reserve on Federal Reserve obligations were removed, this would give us much greater freedom to maneuver, would it not, because it would mean that the available gold supply, instead of being around $6 billion, would be approximately $18 billion; is that not true?

Mr. SMITH. That is right. I would certainly favor the removal of the 25-percent reserve requirement, and the Commission does, too.

Senator DOUGLAS. That would give us much greater strength, would it not, and we would not have to worry as much about withdrawals?

Mr. SMITH. Right. But I have some sympathy with the idea of the Treasury issuing an obligation at a higher interest rate than the market that would be available to foreign central banks and official agencies.

Senator DOUGLAS. At a higher interest rate to foreigners?

Mr. SMITH. This would only be available to foreign central banks and official agencies, and it is simply a device to disconnect the market interest rate structure at home from the balance of payments problem.

Senator DOUGLAS. Do you think that is practicable?

Senator PROXMIRE. If I may interrupt at this point, I would just point out that a Senator on the floor said to me a few moments ago that we are the only free country in the world, except West Germany, which does not restrict the flow of capital.

So we could, if we adopt the policy of other free countries, we could solve this problem just by fiat, by just saying that we will not take advantage of these opportunities abroad which are bound to be inviting for a long, long time, because our interest structure is lower than the interest structure is abroad.

Mr. SMITH. That is true.

Senator PROXMIRE. I am not saying that I advocate this. I heard this recently, and I would be interested in your viewpoint on it as it relates to this, possibly.

Mr. SMITH. I have not really considered the use of exchange controls to restrict international capital movements and I would certainly prefer to avoid such measures. All I am saying is that I think we do need somehow to try to eliminate or at least minimize the balance-of-payments problem as a constraint on monetary policy. It seems to me to have been a rather serious problem during this year, and, as long as we have it, I think it is rather difficult to conduct a really effective monetary policy.

Moreover, if foreign interest rates rise substantially, even keeping the bill rate at 2 to 2½ percent may not be sufficient to prevent an outflow of short-term capital. We simply cannot afford to let our domestic monetary policy be governed by our balance-of-payments situation.

I do not have extensive suggestions to make with respect to how we should get away from this problem, but I think we should certainly try to do it.

All of this was a peripheral comment that was related to the point that Mr. Reuss made earlier to the effect that he felt that this was a time when it would be desirable to lengthen the debt.

Representative REUSS. I want to break a lance with you on that when my time comes.

Mr. SMITH. All right.

Now, in addition to lengthening the debt structure, the Commission believes the Treasury should strive to regularize its debt offerings and to achieve a structure involving fewer issues of larger size in order to facilitate effective trading in the market.

I think these are worthy objectives, and it seems to me that the technique of advance refunding is very valuable as a device for achieving a basic restructuring of the debt, such as this seems to call for.

The Commission recommends against any use of compulsory holding of Treasury securities. As I indicated earlier, it seems to me that the tendency of commercial banks to shift the composition of their portfolios between Government securities and loans—that is, to build up their Government security holding in periods of recession

and easy money and then to unload the Governments and shift into loans at times when we are trying to implement a restrictive policy—has been a major factor weakening monetary policy.

I would like to see some experimentation with secondary reserve requirements on the commercial banks in the form of Government securities to see if such a device could not reduce the scope of such shifts, and thus strengthen monetary controls. That is, I would like to pin down some of the securities and maybe have a variable reserve requirement that could be raised moderately during times when the Federal Reserve was trying to exert a restrictive policy to tie down a higher proportion of the debt in the hands of the commercial banks. I can see no reason why compulsory holding of Government securities by commercial banks is any more repugnant in principle than the present compulsory cash reserve requirements.

Representative GRIFFITHS. May I ask a question?

What would be the adverse effect, if any, upon the banks of such a policy?

Mr. SMITH. It would, of course, reduce, to some extent, the freedom of action of the banks in shifting their portfolios. That would, of course, be the precise objective of the measure, to try to prevent the banks from shifting heavily out of Government securities into loans at a time when the Federal Reserve was trying to exert restrictive monetary policy.

Representative GRIFFITHS. Would the effect upon the banks be to reduce their earning power?

Mr. SMITH. I suppose it very likely would. Any restriction you put on an economic unit to prevent it from following its own interests freely is almost certain to reduce the profitability of that particular economic unit. As it stand now, the banks are free to shift as they please, and this measure might well have some adverse effect on bank earnings.

Representative GRIFFITHS. What, in your judgment, would be the effect on the economy of the Nation?

Mr. SMITH. I would hope that it would help to strengthen monetary controls and make them work more effectively. That is the point. The purpose of it is not to tie down the debt from the point of view of making debt management easier for the Treasury. From my point of view, the purpose is to give the Federal Reserve another weapon of control that would tend to make its monetary policies more effective.

Representative GRIFFITHS. Thank you.

Mr. SMITH. In its discussion of the savings bond program, the Commission expresses opposition to the introduction of constant purchasing power savings bonds. It seems to me, in looking at the record, that such long-term stability in the price level as we have achieved in the past, has been due to the periodic occurrences of catastrophic depressions such as that in the 1930's, which have produced sharp declines in prices and crashed through the downward rigidities in the price structure from time to time.

Senator DOUGLAS. Mr. Smith, it is really somewhat broader than that in that in every war, 1812, the Mexican War, the Civil War, World War I, World War II, we have had a big increase in prices.

Mr. SMITH. Right.

Senator DOUGLAS. And that subsequently there has been a fall.

Mr. SMITH. Right.

Senator DOUGLAS. And this time, after World War II, there has been no such fall.

Mr. SMITH. That is right.

Senator DOUGLAS. To the great consternation of Sewell Avery.

Mr. SMITH. I think the reason for it is that we have succeeded in maintaining a high level of economic activity for the most part. And if we continue to maintain high levels of activity, I would be surprised if we do not experience a gradual updrift of the price level.

If that is the case, it seems to me that there is an argument and a strong one, for the Government to issue a savings bond with a built-in purchasing power guarantee as a device for giving small and unsophisticated investors an opportunity to invest in something that contains some protection against inflation.

I realize there are arguments on both sides of this question, but on balance I believe it would be desirable for the Treasury to introduce a savings bond containing a purchasing power guarantee. Moreover, this would seem to be consistent with the philosophy of the Commission about the savings bond program, since it recognizes the desirability of the issuance by the Government of an asset not subject to price variation to be made available to small investors. I would simply say that it would be desirable to extend this idea to the point of introducing a purchasing power guarantee.

I am not in favor of escalating all kinds of financial assets. It is only this one particular kind of financial asset available to small investors that I would be in favor of doing anything of this kind about.

Finally, like the Commission, I believe it would be undesirable to consolidate the responsibilities for debt management and monetary policy in the hands of a single agency, whether it be the Treasury or the Federal Reserve. It is true that, in principle, there is something to be said for such a consolidation. Many of the actions of the Treasury and the Federal Reserve are of the same kind. The Federal Reserve, by changing the composition of its portfolios through dealings with the public is in a position to change the maturity structure of the publicly held debt. Thus I would view changes in the composition of the Federal Reserve portfolio as really a kind of debt management.

However, I think we know so little about how debt management should be conducted and what its economic effects are that I am a little hesitant about having the debt management and monetary policy responsibilities consolidated. I am a little afraid that if the Federal Reserve were given the responsibility, it would begin to worry about how to finance the Treasury's defiicits and so on to the detriment of conducting a flexible policy directed at economic stabilization, and I think the same would be true if the consolidated responsibility were to rest in the hands of the Treasury. So, until we know more about how debt management works, I would prefer to maintain the present division of responsibility.

I also agree with the Commission that both the debt limit and the interest rate ceiling should be eliminated. The recommendations concerning debt management techniques and the organization of the Government security market are also pretty much in line with my own ideas. I would like to see the Treasury experiment with auctioning

techniques in selling longer term securities, although I think it is debatable whether auctioning in the longer term markets would yield substantial benefits.

I think that is about all I have.

(The entire statement of Mr. Smith is as follows:)

STATEMENT BY WARREN SMITH: COMMENTS ON THE RECOMMENDATIONS OF THE COMMISSION ON MONEY AND CREDIT CONCERNING THE PUBLIC DEBT

Before addressing myself specifically to the public debt and debt management, I would like to say that there is a great deal in the report of the Commission on Money and Credit with which I find myself in agreement. Many of the recommendations in the report have a great deal of merit, and I hope they will receive the serious attention they deserve. I do have one major criticism of the report, however. I believe it fails to face up squarely to the problems arising out of the exercise of market power in the fixing of wages and prices. In my opinion, we are faced with a serious conflict between the objectives of price stability on the one hand and high employment and adequate growth on the other, a conflict which cannot be satisfactorily resolved by the measures—such as vigorous antitrust enforcement, lower tariffs to increase foreign competition, efforts to increase labor mobility, etc.—suggested by the Commission. This conflict is our most serious domestic economic problem, and the effectiveness of the report is marred in several places by the cursory manner in which it is handled.

I. ECONOMIC EFFECTS OF THE DEBT

The chief burdens imposed on the economy by the existing Federal debt are the possible disincentive effects of the taxes that are needed to offset the inflationary potential of the interest payments and the possible constraints that the problems of managing the debt may impose in the freedom of the Federal Reserve in following a flexible monetary policy. The Commission concludes that these problems are not sufficiently serious to justify giving priority to a policy of debt retirement as an end in itself. Rather it concludes that we should select the combination of tax, expenditure, and monetary policies most conducive to stability and growth, with the change in the size of the debt being a resultant of these policies. A budget surplus is an addition to national saving, and it may be desirable to have budget surpluses whenever their use to retire debt, perhaps supplemented by other measures such as easy money and incentive taxation, will result in increased investment without reducing aggregate demand below levels consistent with high employment. This is a view that has been expressed by many economists in the last few years. I believe it is the proper perspective in which to view the public debt, and I am very pleased to see the Commission adopt it.

II. DEBT MANAGEMENT POLICY

The Commission draws a distinction, which I believe is a useful one, between the stock of existing debt as an automatic stabilizer (or destabilizer) and the economic effects produced by marginal changes in the composition of the debt. At times when the Federal Reserve is following a restrictive policy, transfers of Treasury securities may serve as the instrument for the transmission of funds from economic units having excess cash balances to units desiring more funds to spend or lend, thereby producing an increase in the velocity of circulation of money and offsetting in part the effects of the restrictive policy. Since short-term securities exhibit less price variation and market friction than do long-term debt instruments, a debt structure consisting largely of long-term securities is likely to be more conducive to effective monetary policy than a structure composed predominantly of short-term securities. The Commission recognizes this and recommends that an effort be made to arrest the shortening of the debt maturities which has occurred in recent years. I agree that it would be desirable to lengthen debt maturities in the interest of achieving a financial structure more conducive to effective monetary policy.

When it comes to the question of the timing of the debt operations designed to produce the desired change in the debt structure, however, I part company with the Commission's recommendations. The report suggests that the flotations of long-term securities needed to achieve a substantial lengthening of the debt be carried out at a time when economic conditions are such as to require a restrictive

policy, and that once a better debt structure has been achieved, debt management be conducted in a contracyclical fashion, with emphasis on the shortening of debt maturities in recessions and lengthening of maturities during periods of inflation.

According to my definition, debt management includes all actions that affect the composition of the publicity held debt (i.e., the total debt less the portions held by the Treasury investment accounts and the Federal Reserve), and every debt management operation consists essentially of a sale of securities of one maturity and use of the proceeds to retire debt of another maturity. The Commission's conception of debt management seems to coincide with mine, at least approximately. Debt management operations, defined in this way, have effects on the structure of interest rates and on the composition of the public's holdings of liquid assets in the form of claims against the Government. Thus, the sale of long-term securities and retirement of bills raises long-term interest rates and lowers short-term interest rates, and also substitutes less liquid bonds for more liquid bills without changing the total stock of claims held by the public. While such an operation is probably slightly restrictive, such knowledge as we have concerning the influence of interest rates and liquidity on spending decisions suggests that the restrictive effect would be very weak. The effects of debt management operations are decidedly of the second order of importance and clearly much weaker than either monetary or fiscal policy.

The above considerations suggest that a policy of contracyclical debt management of the sort suggested by the Commission would contribute very little to economic stabilization—surely it would accomplish nothing that could not be done better by monetary policy with its greater administrative flexibility. On the other hand, the concentration of debt-lengthening operations in periods of inflation and tight money would probably have the effect of increasing the interest costs to the Treasury very substantially. Although the dynamics of interest cost minimization are very complex, it seems clear that such minimization would call for some concentration of long-term borrowing in periods of low interest rates in order to give the Treasury the benefits of the low rates for the maximum period into the future. In practice, I believe that if the Treasury were to adopt the countercyclical approach to debt management recommended by the Commission, it would find it both so costly and so difficult (due to the fact that it was trying to crowd into the market at a time when private demands were unusually great) to sell long-term bonds in inflationary periods that the effort would not be pressed vigorously. On the other hand, if the countercyclical doctrine were accepted, the Treasury would view it as improper in principle to market long-term debt in periods of recession. The result of this could only be that the debt maturities would continue to shorten.

My view is that the composition of the stock of debts in existence at any time is much more important than the timing of marginal changes in the debt. Therefore, I would suggest that in the interest of keeping down the Treasury's interest cost (which I regard as an objective not to be overlooked) and as a matter of practical feasibility, the Treasury should put some emphasis on debt lengthening during periods of recession and low interest rates. Such a policy would not be entirely lacking in countercyclical benefits, since by driving down short-term open market interest rates, it might have some tendency to encourage banks to expand loans rather than short-term investments, an effect which would be conducive to recovery. And if the debt lengthening should have undesirable effects, these could quite easily be counteracted by a somewhat easier monetary policy on the part of the Federal Reserve.

In addition to some lengthening of the debt structure, the Commission believes the Treasury should strive to regularize its debt offerings and to achieve a structure involving fewer issues of larger size in order to facilitate effective trading in the market. I believe these are worthy objectives, and I suggest that the technique of advance refunding is very valuable as a device for achieving such a basic restructuring of the debt as seems to be called for.

The Commission recommends against any use of compulsory holding of Treasury securities. In my opinion, the tendency of commercial banks to shift the composition of their portfolios systematically between Government securities and loans has been a major factor weakening monetary policy in recent years. I would like to see some experimentation with secondary reserve requirements in the form of Government securities to see if such a device could not reduce the scope of such shifts and thus strengthen monetary controls. I can see no reason why compulsory holding of Government securities by commercial banks is any

more repugnant in principle than the present compulsory cash reserve requirements.

In its discussion of the savings bond program, the Commission expresses opposition to the introduction of constant-purchasing power savings bonds. Such long-term stability of the price level as we have achieved in the past has been due to the periodic occurrence of catastrophic depressions such as that of the 1930's which have produced sharp declines in prices from time to time. If, as we all hope, we are successful in avoiding such devastating episodes in the future, I believe a gradual updrift of the price level is all but inevitable. If this is the case, it seems to be consistent with the Commission's own philosophy concerning the savings bond program for the Government to provide small and unsophisticated investors with a form of investment which includes some protection against the ravages of inflation. Although there are arguments on both sides of this issue, I believe that on balance it would be desirable for the Treasury to introduce a savings bond containing a purchasing power guarantee.

III. FINAL OBSERVATIONS

Like the Commission, I believe it would be undesirable to consolidate the responsibilities for debt management and monetary policy in the hands of a single agency, whether it be the Treasury or the Federal Reserve. I also agree that both the debt limit and the interest rate ceiling should be eliminated. The recommendations concerning debt management techniques and the organization of the Government securities market are also pretty much in line with my own views. I would like to see the Treasury experiment with auction techniques in marketing longer-term securities, although I think it is highly debatable whether auctioning would yield any benefits in these markets.

Senator DOUGLAS. Mrs. Griffiths?

Representative GRIFFITHS. I would like to congratulate you on your statement and I want to say right now I am heartily in favor of the bond with the guaranteed purchasing power.

I presume that you would have to limit the amount that anybody could buy.

Mr. SMITH. I do not see that there would be any more problem about people cashing purchasing power bonds than there would be about cashing the present types.

Representative GRIFFITHS. Would you pay interest on it at the value at which it was purchased and guarantee the purchasing power?

Mr. SMITH. I would tie the interest rate on it as well as its redemption value, to the consumer price index. The interest payment on it would be escalated if the price level went up, and would go down if the price index went down.

Representative GRIFFITHS. I think that is an interesting suggestion.

Mr. SMITH. I think, though, that it would be undesirable to do this with a wide variety of different kinds of financial assets. But I feel that Treasury savings bonds represent an area where it would be pretty safe to introduce this kind of thing.

If you introduced a constant-purchasing power savings bond at a time when inflation was a serious threat, the psychological repercussions of the introduction might be unfortunate. This is one of the reasons many people are against it. They feel that its introduction would suggest that the Treasury had decided that there is no way to stop inflation and had decided to cave in to it. If you were to introduce it at a time when there was not very much worry about inflation, it might be possible to put it into effect without having such serious psychological repercussions.

Representative GRIFFITHS. Thank you very much.

Senator PROXMIRE. In your statement, where you say, "Thus, the sale of long-term securities raises the long-term interest rates," did I understand you to say that the effect of changes in the interest rates are not a matter of unanimous agreement on the part of economists and others, that we are not sure what effect this might have on the economy?

Is that your understanding?

Mr. SMITH. Let me be clear, I am talking about the effect of interest rate changes on expenditures for goods and services. That is, for example, on corporate investment in plant and equipment, and so on, and expenditures on goods and services; not the financial reactions to interest rates.

Senator PROXMIRE. Certainly the effect of interest rates on the expenditure for housing, you can make a pretty clear case; can you not?

Mr. SMITH. This is due to some rather peculiar things. Quite a bit of it is due to the fact that we have had ceilings on the interest rates of Government guaranteed mortgages, which have tended to make the supply of mortgage funds sensitive to interest rate changes.

Senator PROXMIRE. It may be, but I am still saying the fact is that when the Federal Reserve Board followed a policy—what was it, 1955–57—followed a policy of tight money, of high interest rates, that it had the effect, although this was a period of high incomes, a period of expanding economic activity, the housing market just dropped down right through the floor during the next 2 years. You are dead right about the corporate spending. It had no effect at all on this. In fact, we had one of the most startling expansions in corporate investment.

Mr. SMITH. I would just like to qualify this by saying you cannot be sure what the effect was on corporate spending because there are many other things besides interest rates affecting corporate spending at the same time.

Senator PROXMIRE. It might have been a dampening effect.

Mr. SMITH. But the evidence that I have seen that economists have developed suggests that the effect of the interest rate on corporate spending on plant and equipment is very weak. In fact, it is extremely difficult to discern.

Senator PROXMIRE. I am inclined to sympathize with you, but, you know, if you take this viewpoint and push too far, it seems to me you could make an awfully good argument that in periods of inflation what we should do is reduce interest rates from this standpoint.

If it does not have any significant effect on expenditures, one thing you know it has an effect on is the cost of money. Therefore, if you are buying a house, if you are buying a car, if you are buying a refrigerator, the inflation is very visible and direct and obvious there when interest rates go up. The whole argument that classical economists have used to contradict this is that it discourages people from buying because the price of money is high, and, therefore, they avoid buying it. You say that this is not effective. Then it seems to me you can go along with some people who argue—it does not convince many people—who would argue that you should reduce interest rates in times of inflation.

Mr. SMITH. Let me expand on that a little bit, though. I believe the control of the supply of bank credit and the effects that monetary policy has on credit availability have some influence on the level of expenditures and of general economic activity. I would not want to exaggerate how powerful I think this influence is, but I think it is in the right direction. But the effect on the supply of bank reserves is not any different, depending on what kind of securities you buy and sell in the market. This is a matter of the total supply of reserves supplied to the banking system by the Federal Reserve. I think the availability of credit through the banking system is probably the main way in which monetary policy can exert some significant effect. Incidentally, I believe the Federal Reserve's control over credit availability has been weakened by the ability of the banks to change the composition of their portfolios. As I indicated earlier, I would like to see this tightened up.

Senator PROXMIRE. You have concurred, as I understand it, in my observation as to what happened from 1955 to 1957, when the Federal Reserve was following a tight-money policy and increasing interest rates, and making the availability of loans less, and, yet, we had this great expansion in business, in plants and equipment. They bought more than ever before, expanded more rapidly than before.

Mr. SMITH. Well, as I said before, that does not prove that monetary policy did not have some effect in dampening the expansion.

Senator PROXMIRE. It does not make a very good case for it, though.

Mr. SMITH. That is right. And I think monetary policy is not a powerful instrument and we should be very careful not to rely too much on it as a stabilization device.

Senator PROXMIRE. Then I just have one other question. It seems to me that one of the most eloquent passages in Mr. Freeman's statement was when he discussed the Federal Reserve's role as a stalwart defender of price stability.

He pointed out that we have in our economy, although we all tend to deny it, a group of producers who are interested in getting more, and, therefore, it is kind of an inflation lobby. Farmers want more, workers want more, businessmen want more. They feel salaries should be higher, prices should be higher, and they are constantly pushing our economy in that direction.

Now, it seems to me that by adopting this last advice you recommend of a savings bond that is on an escalator, that you wipe out one remnant, one group which is an effective anti-inflation lobby.

If you can wipe this group out, what argument can you make that you should not apply this to social security payments and almost any other kind of payment of this kind? Does this not really let down the bars?

Mr. SMITH. I do not think that the buyers of savings bonds are really a very effective lobby against inflation.

Senator PROXMIRE. There are millions of them, and they are concerned with this. If you read my mail, you would think so because they certainly write to Members of Congress and protest spending on the grounds that this is going to diminish the value of their savings bonds.

Mr. SMITH. More fundamentally than that, though, the thing that bothers me is that unless we make some basic changes in our pricing

machinery, then it seems to me that a policy of fighting inflation by orthodox methods can be successful only by creating unemployment and slowing down the rate of expansion in the economy.

Senator PROXMIRE. Certainly not this way. This way you fight inflation by letting others coast along with it. It would seem to me that you can fight inflation better, although maybe it is going to take a long, tough, hard time, by the kind of thing you suggest so very well, I think, in your initial statement:

That we have to do something about wage increases that exceed productivity increases.

Mr. SMITH. Yes. However, I must say that while I think we should do everything we can in this area to try to minimize inflation, I am not really convinced that we can completely stop it, because I think inflation is due in good part to downward rigidities in the price structure.

Senator PROXMIRE. Due to what?

Mr. SMITH. Downward rigidities in the price structure; when we have a decline in economic activity, the decline tends to be concentrated in declines in production, output, and employment, and prices stay pretty rigid. I am really rather skeptical of our ability to create greater flexibility in the price structure to the point where we can expect declines in the price level during recession periods to balance the almost inevitable increases in the price level that occur during periods of rapid expansion with any kind of controls I can imagine. We are bound to have some rise in the price level in a period of expansion, and if we have a recession to start with, we want that expansion to continue. We do not want to shut it off at its source.

Senator PROXMIRE. Isn't our experience awfully limited, though, to make that judgment?

Mr. SMITH. Perhaps so.

Senator PROXMIRE. After all, in recent months, at least, we have had price stability, quite a bit of wholesale price stability.

Mr. SMITH. But in the long run, absence of secular inflation requires not merely occasional brief preiods of price stability but that prices actually go down sometimes. Indeed the fact that prices have actually fallen very little during the current recession is an ominous portent that the inflation problem is still very much with us.

And I am quite skeptical, unless we are willing to settle for unemployment more substantial than we appear to be willing to accept, whether we can really get declines in the price level to balance the increases we will almost inevitably get in periods of expansion. I feel that the economy has undergone a structural change associated with the emphasis on maintaining high levels of employment, which has introduced an inflationary bias. Maybe we can counteract it and I would like to see us do everything we can to achieve that objective. But nevertheless it seems to me there is much to be said for providing the small investor with some protection against inflation.

Sentor PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Senator DOUGLAS. Congressman Reuss?

Representative REUSS. I would like to pursue with you, Mr. Smith, the problem of lengthening the debt, and particularly the balance of payments point that you make, and I will just run through it very quickly because I think for quite a ways we agree.

(1) The debt ought to be lengthened for a lot of reasons.

(2) You probably cannot do it for a lot of reasons when there is a boom and buoyancy.

(3) Therefore, you have got to do it when there is a recession or less than a boom.

(4) However, if you start doing it during a recession, you thereby tend to drive long-term interest rates up, and this is bad because then the businessman will not borrow and, by building new things, get us out of the recession.

(5) However, and this may be the point on which you want to leave me, you can counteract this by having the "Fed" join the team, so to speak, and looking at its badly unbalanced portfolio, 95 percent shorts, 5 percent longs, alter that a bit in the direction of longs.

For example, suppose the "Fed" in the next months, assuming the money supply stays equal, sells about a billion dollars worth of shorts and buys about a billion dollars worth of longs.

If it did this, it would substantially meet the point we are talking about, because it would have removed that many long terms from the hands of people who are in the market normally for long terms and thus enabled them to buy a hypothetical additional billion dollars worth of new Federal long-term securities.

Up to this point, I think we were more or less in agreement. And then you said:

> Ah, but the balance of payments puts a terrible constraint on us, because if interest rates are widely disparate between this country and broad, hot money leaves us, and this causes us all sorts of troubles.

This is where I left you, because it seems to me that if the "Fed" sells short terms, it will add to the supply of short terms on the market, the price will, therefore, go down, and the yield will go up, and far from hurting our balance-of-payments posture, it will have the incidental, byproduct effect of helping.

Mr. SMITH. To begin with, I really have some doubt, after having observed what has happened lately and the kind of interest rate structure you get and the apparent reactions of investors in periods such as the present, whether you can really accomplish very much by playing this rate pattern game. That is, I do not think that you can drive long-term rates down substantially unless you are prepared to permit short-term rates to drop, too.

The reason is that in periods like this, most investors expect that interest rates are going to go up before long, and if you start trying to drive long-term interest rates down and long-term security prices up, I think you will find that most investors will tend to retreat into the short-term market on account of the risks of unfavorable price variation in the market for long-term securities.

So I do not feel that you can conduct a really effective, flexible monetary policy as long as you are constrained by that short-term interest rate peg. Similarly, it seems to me that if you should attempt to sell longer-term securities in order to lengthen the debt and this should drive up the interest rate on longer-term securities unduly, you would have to try to compensate for it by a generally easier monetary policy, which would have a tendency to bring down the whole interest-rate structure, including short-term interest rates. If you were not prepared to let short-term interest rates drop, you would be

constrained from following a sufficiently easy general monetary policy to compensate for the effect of the long-term sales on long-term interest rates.

Representative REUSS. I think you have attributed to me a desire for the purposes of this model to bring down long-term interest rates, which I do not really have.

I would be quite content for the model we are talking about to keep them about where they are.

What we are talking about is lengthening the debt at the only time in the cycle when you and I think that it can effectively be done, that is, a time like the present. Then you come in with your balance of payments point.

Mr. SMITH. If you sell some long-term securities, you are going to have some tendency to drive up the long-term rate, unless the Federal Reserve takes these.

Representative REUSS. What I have said in my model is, let the Fed buy a billion dollars worth of long terms in the next year, and over that same period in some sort of a calibrated fashion let the Treasury issue about a billion dollars worth.

Mr. SMITH. My point, though, is that you have not really lengthened the debt if you do that.

Representative REUSS. Oh, but you have lengthened it.

Mr. SMITH. No, you have not. If the Treasury sells a billion of long terms and the Fed buys a billion of long terms, you have not lengthened the debt. I do not count the debt held by the Federal Reserve as part of the debt at all because this is held internally. I can see some advantage in the Fed lengthening its portfolio from the standpoint of having a portfolio that enables it to conduct more flexible operations—in fact, I think there is much to be said for this and that the Fed has undesirably permitted its portfolio to get short. But, as a debt management operation, if the Treasury sells a billion of long-term bonds, and the Fed buys——

Representative REUSS. And sells a billion of short-term securities. The money supply remains equal.

Mr. SMITH. Yes. But you have to take account of the fact that presumably in this framework the Treasury's total debt requirements are fixed by the budget, and if they had not sold the billion of long-term securities, they would have had to sell a billion of short-term securities.

Representative REUSS. I do, and I am talking about real life. We are now in a deficit period.

Mr. SMITH. Right.

Representative REUSS. We have got 3 or 4 or 5 billion to float, and I am saying, float part of the long instead of all of it short.

I think that you can accomplish every purpose that we have in mind. You can lengthen the debt, you can avoid disruption of the long-term interest rate, and you can give a little added moxie to push to raise short-term interest rates, and thus avoid flights from the dollar.

Mr. SMITH. Let me qualify it by saying that I am not against some very moderate effort to do this. But I think we are more constrained than normally in this respect because if the net sale of long-term securities to the public should have an undesirable restrictive effect,

we could not compensate for this by a generally easier monetary policy, as long as we insisted on keeping the short-term interest rate pegged.

We could compensate for it by a purchase of long-term securities, but then we would simply wipe out the debt extension. Since I do not think that the interest rate variations are terribly important, I think if we are careful about it, we could sell some longer term securities in the present situation, but I think it is a situation in which we have to be more careful about debt extension than we normally would if we were not constrained with respect to the general flexibility of interest rates by this balance of payments problem. That is all.

Representative REUSS. I think you tend to overlook or minimize what I regard as an important part of this: namely, it is very much better for the Treasury, other things being equal, if a given long-term issue is held by the Fed than by the public.

This is so, I suggest, because the Fed has now got $27 billion of the national debt. If the Fed in years to come does what the majority of the Joint Economic Committee has repeatedly begged it to do, namely, make increases over the years in money supply by adding to its holding of the national debt, it has got to hold something either short term or long term. Now, if it holds long terms and puts those long terms into the cigarbox from now to eternity, this is going to be of considerable help to the Treasury without being of the slightest detriment to the main mission of the Federal Reserve.

Instead, one of the troubles with our national debt is that, whereas, there are all kinds of people and corporations that are desirous of buying 90-day bills, the equivalent of money, they are a great investment, there is a great demand for them, increasingly there has been a paucity of demand for good old 20-year and 30-year bonds.

Part of this has been due to the Government's own creation of competing media, like insured Federal savings and loan shares. So, to take advantage of life as it is, why not change that Fed portfolio over a period of time in a modest way? Would that not accomplish all these purposes?

Mr. SMITH. It seems to me it does not make a bit of difference whether the Fed adds to its portfolio by buying its securities in the market or whether it adds to its long-term portfolio by buying the securities from the Treasury. I suppose it could be argued, assuming there is no coordination between the Fed and the Treasury, that if the Treasury, say, offers a given issue of long-term securities in the market, the more of these the Fed buys, the less the Treasury sells to the public, and the less is the effect in lengthening the debt. But this does not seem a very plausible way to look at the matter.

Representative REUSS. In my model, I do not have the Fed buying any from the Treasury. I have the Fed making a switch. The Fed sells a billion shorts, buys a billion longs, and the Treasury, all by itself, issues a billion of new securities.

Mr. SMITH. Long?

Representative REUSS. Long.

Mr. SMITH. Yes, but this is the same thing as though the Fed bought the billion of securities from the Treasury in terms of its net effect.

Representative REUSS. Yes, but you said there was a big difference between the two a minute ago.

Mr. SMITH. What you have to try to do is to figure out the effects of the alternative policies on the composition of the debt held by the public outside the Treasury and the Federal Reserve, and I suppose it depends on what assumptions you make about what the Treasury would have done if the Federal Reserve had not bought the billion dollars of securities.

I would think, generally speeaking, that if the Treasury decides to offer a billion dollars of securities and the Fed then buys up an equivalent amount, the net effect on the composition of the debt held by the public would be zero. It would be perhaps desirable from the standpoint of giving the Federal Reserve a better balanced portfolio so it can conduct operations more flexibly in different sectors of the market, which I happen to think should be done. But from the standpoint of debt management, I cannot see that you would gain anything from it.

Representative REUSS. The Treasury has got to issue a billion dollars' worth of something to pay the help on Saturday night under our assumption. Now, it matters tremendously whether the billion dollars' worth of securities they issue are 90-day bills or 30-year bonds.

Mr. SMITH. Except the trouble is that they sell bonds, the Fed buys bonds, and the Fed issues bills so the public winds up with bills whether the Treasury or the Fed issues them.

Representative REUSS. There is a billion dollars' worth of addition to the national debt on this assumption.

Mr. SMITH. Yes. And the question is whether it shall be bills or whether it shall be bonds. And it does not, as far as I can see, make any appreciable difference whether the Treasury sells bills or whether it sells bonds and then the Federal Reserve turns around and buys the bonds and sells bills. The public winds up with bills in either case.

Representative REUSS. We shall both have to study this transcript and the arithmetic.

Senator DOUGLAS. Further questions?

There is only one question I would like to ask and that is your very last sentence. You favor experimentation with auction techniques. Then you say:

> I think it is highly debatable whether auctioning would yield any benefits in these markets.

Now, if I may make this point, has not every issue of long-term securities been greatly oversubscribed with one exception?

Mr. SMITH. Right.

Senator DOUGLAS. And the oversubscription has been very large; has it not?

Mr. SMITH. Yes.

Senator DOUGLAS. And while there is some hedging, so to speak——

Mr. SMITH. A lot of it.

Senator DOUGLAS (continuing). Still, even discounting the hedge group, there has been a real oversubscription; is that not true?

Mr. SMITH. That is true.

Senator DOUGLAS. Does it not follow, when at a given price the quantity demanded exceeds the supply, would one not get a higher price in a competitive market? I mean theoretically?

Mr. SMITH. Yes.

Senator DOUGLAS. And the higher price would mean a lower yield; would it not?

Mr. SMITH. Right.

Senator DOUGLAS. Therefore, there would be a saving in interest rates?

Mr. SMITH. I do not think the last thing follows, because I think the danger that you run into is that if you adopted auctioning, the whole structure of the market might change very substantially, because the risk to the investor of participating in the market is considerably greater under an auction, particularly one where he pays the price that he bids for the securities.

Now, in that case the Treasury in a sense captures some consumer surplus. But, on the other hand, the risk to the investor is increased, because if he happens to place a bid that is substantially away from the market, he is going to wind up with a security whose price is going to fall immediately after the sale, and what I am a little scared of on the auctioning is that it may tend to drive a good many investors out of the Government market, and tend to concentrate the market in the hands of only a relative handful of highly sophisticated investors who feel confident in making a bid close to the market.

Senator DOUGLAS. The Government, however, would get a higher price on the security?

Mr. SMITH. True, if all the participants in the market that are now there stay there, it would work the way you say. But if auctioning should drive a substantial number of bidders out of the market, the result might be entirely different.

Senator DOUGLAS. Then if it is highly debatable whether there are any benefits in it, why do you advocate it?

Mr. SMITH. I would like to see it tried and see if we cannot tell whether there are some benefits from it. Maybe my concluding remark was a gratuitous statement, because I really would like to see the Treasury try the auction device and see if it can judge whether it is beneficial or not. But I do not advocate it unreservedly, because I am not sure that it would be beneficial. I do not think you can really tell. Maybe you will have difficulty telling, even after the Treasury tries it, whether you are better off with the auction.

Senator DOUGLAS. You will remember a very valuable member of our staff who wanted the Treasury to broaden the market of investors for long-term Government securities to tap new sources of investors.

Could that not be used to offset any possible narrowing of the purchases?

Mr. SMITH. If there are ways in which the Treasury could broaden the market, it could presumably do those things under the present arrangements, and it is a question whether the net effect of auctioning, taken by itself apart from anything else that was done, would broaden it or narrow it.

Senator DOUGLAS. Anyway, you would like to see the Treasury try it?

Mr. SMITH. I would like to see the Treasury try it.

Senator PROXMIRE. Let me ask one more question along the lines that Mr. Reuss was asking.

Let us assume the Treasury has a billion dollars that it has to raise by refunding that it needs. It has the alternative of selling to the public or to the Fed.

Mr. SMITH. Yes.

Senator PROXMIRE. Or at least the Fed has the alternative of buying it or letting the public buy it. Now, let us assume that the Fed buys it.

No. 1, it has the effect of expanding the money supply.

Mr. SMITH. It has the effect of expanding bank reserves and expanding the money supply some multiple of the amount the Fed bought. This is, of course, on the assumption that it is a net increase in Fed purchases over and above the amount that would have been bought in any case.

Senator PROXMIRE. So, we might argue, this is good policy now under present circumstances in view of the increase in gross national product and the relative contraction over time of the money supply,

No. 2, the Treasury pays interest to itself instead of to the public so the taxpayers' cost is almost nil. This is with the Fed as contrasted to selling to the public, right?

Mr. SMITH. Right.

Senator PROXMIRE. And, No. 3, you do not drive up long-term interest rates by selling to the Fed, whereas, you do if you sell to the public.

Mr. SMITH. Right.

Senator PROXMIRE. It seems to me that all three of these objectives, which at least as I look at the economic situation and as many members of this committee look at it, these are the three objectives we would like to achieve.

We would like to expand the money supply; we would like to reduce the cost to the Treasury and to the taxpayer; and we would like to do this without driving interest rates on long-term obligations up.

Mr. SMITH. It seems to me that all that comes down to is that you would like to see the Federal Reserve adopt an easier monetary policy than has been adopted and implement that policy by open market purchases in the long-term market. It does not make any difference whether they buy securities that are currently being issued by the Treasury to finance the deficit or whether they go into the market and buy existing Government securities. What your suggestion amounts to is that you think it would be desirable for the Federal Reserve to follow an easier policy and increase the money supply to a greater extent.

Senator PROXMIRE. Yes. You know, I raised this point the other day with a very gifted man appointed to the Federal Reserve, and he argued that you should not expand the money supply further because of the international situation.

Mr. SMITH. I am inclined to agree, to some extent, with that. If you are really going to follow a substantially easier monetary policy, I think that you have simply got to let that short-term rate go down and cut the discount rate, which is one of the things tending to hold it up there. And you have to get away from the policy which the Federal Reserve can be said to have followed in the last few months, as I said before, of keeping the short rate pegged somewhere around 2¼ percent. This seems to me to have put a constraint on the extent to which we have been able to follow a really potent easy money policy during the recession period. And I think that there are difficulties in getting around that restriction and following a very much

easier policy than we have been following as long as that constraint continues to exist.

Senator PROXMIRE. We have already discussed our viewpoint on that.

I want to thank you very much, Mr. Smith.

Thank you, Mr. Chairman.

Senator DOUGLAS. Thank you, Mr. Smith.

We will reconvene at 10 o'clock tomorrow morning, on the Senate side, when we will hear Mr. Miller and Professor Gurley discussing the section of the report on private financial institutions.

I want to thank the witnesses this afternoon for their very able testimony.

ANSWERS OF WARREN L. SMITH TO QUESTIONS PROPOUNDED BY THE JOINT ECONOMIC COMMITTEE

Question 1. You speak of "our most serious domestic economic problem" as the conflict between, on the one hand, the objectives of price stability, and on the other hand, high employment and adequate growth.

(*a*) How "serious," in your view, is this conflict? Would you elaborate upon the basis for your conclusion.

(*b*) Seemingly you attribute this conflict to the presence of market power over wages and prices. Yet you also state that it cannot be satisfactorily resolved by such measures as vigorous antitrust enforcement, lower tariffs to increase foreign competition, efforts to increase labor mobility, etc. Why, in your opinion, are these techniques not adequate to resolve substantially this market power? What measures do you suggset for dealing with this problem?

Answer to (*a*). Our experience in the last few years, especially since 1955, suggests, in my judgment, that we are faced with an inflationary problem that stems in good part from a tendency for the average level of money wages to be pushed up more rapidly than the productivity of labor for the economy as a whole. This process does not operate evenly, however. In years of recovery, such as 1955, 1959, and 1961, labor productivity increases rapidly and it is possible to absorb substantial wage increases without raising unit costs and pushing up prices. In later stages of periods of expansion, however, as the economy approaches capacity operations, the rate of increase in productivity slows down, but high profits and high employment tend to produce wage increases in excess of productivity advances with inflationary consequences. These tendencies seem to be strongest in industries, such as automobiles and steel, that are characterized by oligopolistic concentration in the product market and by strong aggressive unions. Wage increases in concentrated industries tend to be transmitted, although with some modifications, to other sectors of the economy, and products of some of these industries enter as inputs in other industries. Thus, the inflationary process tends to spread throughout the economy by a kind of "markup" process.

Of course, excessive aggregate demand may also be a source of inflation, but there is little evidence that, by any reasonable standard, we have experienced such an excess demand situation since 1955. In addition to its positive contribution to inflation as described above, I believe market power has also contributed to a gradual upward drift in the price level through the downward rigidity it introduces into our price structure. The price level has shown a marked tendency to remain constant or even to rise somewhat during recession periods. In many industries, reductions in demand result in declines in output and employment, while increases in demand have a much stronger tendency to produce upward adjustments in prices and wages. As long as prices do not fall during recessions, a gradual upward drift in the price level seems inevitable, since it is almost impossible to prevent some rise in the price level during expansions. Moreover, when prices are more flexible upward than downward, changes in the composition of demand with aggregate demand constant (i.e., a shift of demand from one industry or sector to another), can initiate an inflationary process. I believe all of these inflationary manifestations of market power have been at work at one time or another since 1955.

Although much of our recent inflationary experience seems to have been due to the exercise of market power, I do not believe it is proper to "blame" the inflation on either labor or business. In our present-day economic system large business units and large labor organizations are virtually inevitable, and under these conditions, the classical mechanism of determining the distribution of income between labor and capital—whatever may have been its merits in earlier, simpler times—has broken down. The inflationary process seems to be a byproduct of a legitimate struggle concerning the division of our national product between labor and capital.

Incidentally, I believe it is not proper to draw encouragement from the fact that we have not had any appreciable increase in prices in recent months. As indicated above, if we are to avoid a secular upward drift in the price level, it will be necessary for prices to fall in recession periods such as 1960–61. The fact that there has been no appreciable decline in prices during this period is, I believe, an ominous portent that the problem of inflation is still very much with us.

Of course, it is possible to check market power inflation by restricting aggregate demand by means of monetary and fiscal policy. Eventually the increase in unemployment induced by a restrictive policy is likely to weaken the upward pressures on the money wage level and the softening of demand in product markets should induce employers to resist wage increases more vigorously. However, recent experience suggests that a very substantial level of unemployment and underutilization of productive capacity is likely to be necessary to stabilize the price level by this means. For example, in recent months the consumer price index has drifted upward slightly in spite of an unemployment rate in the neighborhod of 7 percent of the labor force. It should also be noted that substantial underutilization of existing productive capacity tends to discourage private investment, thereby slowing down the pace of economic growth.

There are other factors in our inflationary experience of recent years, such as a tendency for the demand for many kinds of services (such as medical care) to increase more rapidly than supply. Moreover, a part of the increase in the price level is undoubtedly a product of upward biases in our price indexes. Nevertheless, I believe the exercise of market power has been a very important source of our troubles and constitutes our most troublesome domestic economic problem. I also believe that as a nation we have—like the Commission on Money and Credit—failed to face this issue squarely and to devise appropriate measures to deal with it or to adjust our policies to its existence.

Answer to (*b*). Let me make it clear that, like most economists, I am in favor of all the measures referred to—vigorous antitrust enforcement, lower tariffs, and efforts to increase labor mobility. However, I do not believe they are capable of solving the problem of market power inflation. Many of our most important industries need to be organized in a few large producing units in order to gain the advantages of large-scale production and distribution and to achieve the benefits of progressive technology. This leads to oligopolistic market structures which reasonable enforcement of the antitrust laws is powerless to prevent, and I know of no reasonable proposal for bringing antitrust policy to bear on labor unions in such a way as to prevent inflationary wage pressures without seriously weakening the labor movement, a result that would be extremely undesirable, in my opinion, as a matter of social policy, as well as presumably completely impractical from a political standpoint. The additional foreign competition resulting from tariff reductions would in all probability be no more than a minor influence on our wage-price situation. Moreover, most of our competitors in international trade are plagued by the same problem of market power inflation as we are, and the most we could expect from foreign competition would be to keep our price level from rising more rapidly than the price levels of competitor countries. This would assuredly leave us with a substantial inflation problem; in fact, many countries have experienced more rapid inflation than we have, so that increased competition might contribute more to their stability than to ours. Increased labor mobiliy would help us, but in the absence of a very extensive program, I am skeptical as to the magnitude of its contribution.

The truth is that as long as we set high standards for our own economy with respect to employment and growth, I doubt whether we will be able to prevent completely some secular upward drift of our price level. However, I believe we should do everything we can to minimize the inflationary drift without seriously compromising our objectives of employment and growth. In particular,

I would favor the establishment of an agency in the executive branch of the Government with investigatory powers to represent the public interest in the key negotiations concerning wages and price in our major industries. To begin with at least, I would limit the authority of such an agency to investigation, impractical factfinding, and appeals to public opinion to obtain wage-price settlements that would minimize the danger of inflation.

Question 2. Although you agree that debt maturities should be lengthened, you are critical of the CMC recommendation that this be accomplished in a contracyclical fashion—that is, shortening debt maturities in recessions and lengthening them during periods of inflation. Instead you propose that maturities should be lengthened during periods of recession.

(*a*) Since debt lengthening operations tend to increase long-term interest rates, why would your recommendation not work in such a way as to aggravate a recession by reducing investment and some categories of consumption? What evidence is there that the stimulative effects of reduced short-term rates will offset the contractive effects of higher long-term rates?

(*b*) Could not the maturity structure of the debt be increased very easily, without producing adverse economic consequences, if the Federal Reserve were to expand substantially its holdings of bonds and reduce, as necessary, its holdings of shorter term issues, especially those in the intermediate range? And would this not also be likely to have other benefits, such as the reduction of long-term interest rates?

Answer to (*a*). There is very little evidence that either long-term interest rates or short-term interest rates have any appreciable effects on most spending decisions, at least within the short time periods that are relevant for purposes of cyclical stabilization. In fact, despite numerous and extensive investigations by means of interviews with businessmen as well as by the use of econometric techniques, the evidence is so slight that I do not believe there is any solid empirical basis for a conclusion as to the relative strength of the effects of short-term as compared with long-term interest rates.

There are a number of reasons for the insensitivity of expenditures to long-term interest rates. As far as business investment is concerned, such long-term borrowing as is done is mostly for the purpose of financing investment in long-lived assets such as plant and equipment. However, three-fourths or more of the funds for such investment are obtained from internal sources (retained earnings and depreciation allowances) and investment of such funds is little influenced by interest rates. Many businesses are reluctant to borrow to finance investment, and when they do borrow, the interest rate is not an important factor in their investment decisions. The reason for this is that the risks associated with long-term investment are so great as to swamp the effects of moderate variations in the interest rate.

The one area where long-term interest rates have clearly had a significant effect is in the field of residential construction. In recent years, rising interest rates resulting from a restrictive monetary policy have had a rather prompt tendency to bring about reductions in housing starts and expenditures, and easy money and falling interest rates have tended to stimulate residential construction. However, it appears that these effects have been due to institutional peculiarities in the field of mortgage finance, particularly the existence of legal ceilings on the interest rates on FHA insured and VA guaranteed mortgages. As a result of these ceilings, rising interest rates on corporate and State and local government securities have tended to atract funds away from Government-backed mortgages, thus starving the mortgage market for funds and slowing down residential construction, while falling interest rates have had the opposite effect. While these tendencies have been helpful to general economic stability, they have aroused the opposition of home builders and housing enthusiasts. It seems a bit foolish to push long-term interest rates up and down with resulting sharp fluctuations in the market value of debt instruments almost solely for the purpose of controlling mortgage credit and housing construction. If it is desired to continue using housing as a cyclical stabilizer, it would probably be better to eliminate the interest ceilings and introduce specific selective controls as the Commission on Money and Credit recommends.

It should also be noted that if the Treasury were to borrow at long term in recession periods for the purpose of lengthening the debt, as I suggest, the net effect on long-term interest rates would not be as great as might at first be expected. As long-term interest rates were raised, thus widening the margin between long- and short-term rates, suppliers of funds would respond by shifting

funds from the short- to the long-term market, thus moderating the rise in long-term rates and causing short-term rates to rise.

I should emphasize that I believe the policy of debt lengthening in recessions should be pursued with caution and moderation. Nor do I mean to imply that no long-term borrowing should be done in boom periods. But I do feel that such borrowing is likely to prove so costly and difficult that as a practical matter it will not be sufficient to overcome the shortening of the debt that results from the passage of time. I believe a cautious emphasis on debt lengthening in recessions will do no harm to the economy and that if it should appear to slow the pace of recovery, its effects can readily be offset by a further moderate general easing of monetary policy.

I do believe that countercyclical monetary and credit policy can make a modest contribution to economic stabilization but that its effects are largely produced by regulating the availability of bank credit rather than through changes in the interest rate structure. The supply of bank credit is not affected by debt management decisions but is governed by the Federal Reserve's decisions concerning the scale (but not the maturity sector) of its open market operations and by its decisions concerning reserve requirements.

Answer to (b). Purchasers of long-term securities by the Federal Reserve combined with sales of shorter-term issues would shorten the average maturity of the debt rather than lengthen it—that is, it would have precisely the opposite effect to that suggested in the question. The proper concept of the debt for purposes of economic analysis is the publicly held debt—that is, the total debt less the securities held by the Government agencies and trust funds and by the Federal Reserve. The debt held by the Federal Reserve does not influence economic decisions, and interest payments by the Federal Reserve impose almost no burden on the Treasury since nearly all of any additional such payments are returned to the Treasury by the Federal Reserve at the end of the year. Purchases of long-term securities by the Federal Reserve and equivalent sales of short-term securities would reduce the public's holdings of long-term securities, thereby reducing the average maturity of the publicly held debt.

Question 3. This question concerns the marketing of Government securities.

(*a*) As you know, at the present time Government bonds are sold by the Treasury at administered prices instead of via the auction technique employed in the case of bills. Normally this will mean that some bond purchasers will pay less than they otherwise would have. In commenting on the proposal that the Treasury experiment with the auction technique in the sale of bonds, you say that it is "highly debatable whether auctioning would yield any benefits in these markets." Why are you of this opinion?

(*b*) In the case of U.S. Government bills a secondary market is maintained by a small number, now 18, of private bank and nonbank dealers who derive their gain through the purchase and sale of these securities. Do you feel that the characteristics of this market are such as to operate disadvantageously from the standpoint of monetary policy—this is, perhaps accentuating unduly the movement of bill prices? Further, would you comment on the desirability of using the Federal Reserve banks as a substitute for the private dealers in maintaining the secondary market?

Answer to (*a*). Under the usual auction technique, such as is now employed in the sale of Treasury bills, each investor buys his securities at the highest price he would be willing to pay for them. The Treasury acts in effect like a discriminating monopolist and, in principle, reaps a benefit which is analogous to the concept of "consumer surplus" often employed in economic analysis. The Treasury's interest costs would be reduced by adopting this type of auctioning arrangement in the marketing of lower-term securities provided the demand curve for securities would remain the same as under the present fixed price marketing technique. However, the risks to the investor would be considerably greater than under the present arrangement. Present practice is to set the coupon rate on new issues slightly above the market rate for equivalent outstanding securities. There is commonly some slight price appreciation immediately after issuance, which provides the Treasury with some underwriting support and gives some protection to investors. Since long-term securities are subject to substantial price variation, the adoption of the auctioning technique might tend to drive all but the most sophisticated investors out of the market, because an investor who misjudged the market and placed an unduly high bid might be subjected to an immediate and substantial loss. In other words, auctioning would impose more risk on investors than the present arrangement, and the additional amount

the Treasury would have to pay investors to induce them to accept the additional risk would presumably cancel out at least part of the gain to be had from capturing the "consumers' surplus." In fact, I regard it as conceivable that the adoption of auctioning would so narrow the participation in the marketing of new securities as to create a danger of collusive bidding by a few market professionals, with the result that interest costs to the Treasury would actually be increased.

An alternative proposal is that the Treasury auction its securities, but instead of charging each investor his bid price, all securities be sold at the price necessary to attract the marginal buyer for the amount of securities the Treasury desires to sell. This arrangement would impose less risk on investors than the auction technique referred to above but more than they are subjected to render the present arrangement since they would not know in advance the price they might actually be called upon to pay. On the other hand, under this scheme the Treasury would not gain the advantage of collecting the "consumers' surplus." It seems very doubtful to me whether there would be any substantial interest saving under this arrangement as compared with present procedures.

Of course, the advantages or disadvantages of the present fixed price techniques depend upon how skillful Treasury officials are in setting security prices so as to maximize the benefits to the Treasury. The present system could conceivably be costly to the Treasury because officials were either inept or inclined to show favoritism toward the interests of investors. One advantage of auctioning would be that it would eliminate these possibilities—or even the suspicion of their existence.

I would like to see the Treasury experiment with auctioning in the sale of longer term securities, although I am inclined to doubt that it would yield great benefits. In fact, I think the importance of this question has been greatly exaggerated.

Answer to (b). As far as I can see, the Treasury bill market functions in a satisfactory manner from the standpoint of monetary policy. The substantial fluctuations in the yields on bills (contrary to the statement in the question, bill prices do not fluctuate greatly due simply to the fact the changes in the yields on short-term debt instruments do not cause corresponding changes in their prices) are almost inevitable due to the short-term nature of these instruments and the play of investor expectations in determining the interest rate structure. Short-term (day-to-day and week-to-week) fluctuations in bill yields have little effect on economic activity and, within reasonable limits, are a matter of relatively little importance. On the other hand the secondary market for longer term Treasury securities exhibits a much less satisfactory performance. The market is thin and subject to relatively large price variations, and the transactions of dealers for their own account probably tend to accentuate rather than to counteract most of the significant price movements.

The dealer market in Government securities combines the features of competitive and negotiated markets in a most peculiar way and is hardly the perfect instrument for the promotion of the public interest that its propagandists try to make it out to be. I believe this market bears careful watching, and, in principle, I can see no objection to the performance of secondary market functions by the Federal Reserve, although the details of such a proposal would require a great deal more thought than I have ever given them before the desirability of such a radical change could be properly assessed. One rather serious difficulty is that the Federal Reserve deals in Federal funds so that its secondary market operations would necessarily produce effects on the supply of bank reserves. This might make it quite difficult to dovetail the Federal Reserves secondary market operations with its responsibility for management of the supply of money and bank credit in the interest of economic stability.

Question 4. You favor experimenting with a secondary reserve requirement in the form of Government securities, disagreeing with the CMC in this respect. What should be the general characteristics of such a scheme, in your opinion? Would it be applicable only to commercial banks or to other financial institutions as well?

Answer. In my opinion, the most important factor weakening the effectiveness of monetary policy as a means of controlling aggregate demand in recent years has been the tendency of commercial banks to build up their holdings of Government securities during recession periods and then, during periods of inflation when the Federal Reserve has been trying to restrict credit, to sell these securities in the market and shift into loans. While such shifts do not increase

the supply of money, they almost certainly increase the velocity of monetary circulation, thus reducing the effectiveness of the restrictive policy.

I believe it would be possible to reduce the tendency of the banks to shift from Government securities to loans during periods when a restrictive policy is being applied by imposing a secondary reserve requirement on member banks. I would suggest a requirement of 25 percent of demand deposits (in addition to present cash reserve requirements) to be held in the form of a special nonmarketable issue of Treasury securities which would be readily obtainable from and redeemable at the Treasury (with the Federal Reserve banks serving as agents in the transactions). The Treasury would use any net proceeds from sale of these securities to retire other debt in the market or cover any excess of redemptions of special securities over sales by borrowing in the market. I believe a 25-percent requirement could be put into effect without undue hardship to the banks. In addition, I would give the Federal Reserve limited authority to raise or lower the requirement, although even without frequent changes, a requirement of the type I am suggesting probably would substantially reduce the instability in the composition of bank portfolios and tighten monetary controls.

Of course, it is not possible to predict accurately how effective such a scheme might be, but I would like to see it tried on an experimental basis to see whether it would strengthen Federal Reserve policy. I cannot see any reason why a security reserve requirement is any more objectionable in principle than our present cash reserve requirements. The Commission on Money and Credit contends that the imposition of such a requirement would raise interest rates on private debt. I do not, however, see any valid basis for this contention, since if we assume that the Federal Reserve's objectives with respect to aggregate demand for goods and services are given independently of the requirement and if rising interest rates have any tendency to restrict demand, the system would presumably have to counteract any tendency that a secondary reserve requirement might have to raise interest rates on private debt by following a generally easier monetary policy, thus restoring interest rates to their original level.

Question 5. Professor Smith, you agree with the CMC that it would be undesirable to consolidate the responsibilities for debt management in the hands of a single agency, whether it be the Treasury or the Fed.

But would there not be major advantages in having, say, the Fed directly responsible, on a day-to-day basis, for handling our debt operations. Would this not actually assist the Fed in effecting monetary policy? And in fact does not the central bank, in most foreign countries, typically handle the government's debt operations?

Answer. In principle, I agree that there is something to be said for consolidating monetary policy and debt management in the hands of one agency, since they have many common characteristics. However, I believe it is useful to make a distinction between debt management and monetary policy. As I view the matter, debt management includes all measures which affect the composition of the public's interest-bearing debt claims (i.e., excluding monetary claims) against the Government. Under this definition, every debt management operation reduces to a swap of one type of interest-bearing claim for another with no effect on the supply of money. Monetary policy, on the other hand, includes all measures which change the publicly held money supply (which I prefer to define as including currency and demand deposits). Thus, all of the Treasury's new borrowing, debt retirement, and refunding decisions fall under the heading of debt management, while the Federal Reserve's decisions concerning the scale of its open-market operations, and concerning reserve requirements and discount rates are included in monetary policy. The Treasury has some minor monetary policy powers which it can exercise chiefly through the process of accumulating or decumulating cash balances and shifting funds back and forth between its accounts at Federal Reserve banks and at commercial banks. Normally, however, I believe it is undesirable for the Treasury to use these powers for deliberate monetary control purposes, since they can accomplish nothing that cannot be done by the Federal Reserve. Rather I believe the Treasury should try (as it has done for the most part in recent years) to manage its cash balances so as to minimize their monetary effects and to avoid making life more complicated for the Federal Reserve. The Federal Reserve can also engage in debt management, since changes in the composition of its portfolio of governmental securities produce corresponding changes in the composition of the public's holdings of interest-bearing debt. For several years up until recently the Federal Reserve, under the "bills only" policy has largely refrained from using its debt management powers, however.

If we really understood the economic effects produced by changes in the composition of the publicly held debt and in the interest rate structure, it might be desirable to use debt management as a countercyclical weapon, and it would then be desirable to consolidated debt management and monetary policy in the hands of a single agency, preferably the Federal Reserve. However, as I stated in answer to an earlier question, I do not believe we know much about these effects beyond the fact that they do not appear to be very important. Accordingly, under present circumstances, I prefer to retain the present division of responsibility, because I am afraid if debt management were turned over to the Federal Reserve, the System would become so concerned about the traditional Treasury task of "raising money" that its true function of contributing to economic stabilization would be weakened.

I do feel that it is desirable for the Federal Reserve to give up the "bills only" policy, however. While purchases and sales of Treasury bills are commonly a proper means of controlling bank reserves and money supply, an occasional situation arises in which it is appropriate for the System to deal in longer term securities. Accordingly, I believe it is undesirable for the Federal Reserve to place any self-imposed restrictions on its freedom of action in open-market operations.

It is true that in many foreign countries the central bank plays a major role in the management of the public debt. However, there are also many other differences between our financial structure and banking system and those of other countries. Our credit control techniques are also in some respects unique—we have been considerably less willing than have many other countries to employ direct credit rationing devices and to make use of various types of selective controls. In Britain, the Bank of England has substantial responsibilities in the field of debt management, but the reason for this is partly that the British commercial banks have traditionally had self-imposed minimum ratios of liquid assets (including short-term government securities) to deposits, and this has made the funding and unfunding of the national debt an important factor in controlling the money supply, thus resulting in a closer link between debt management and monetary policy than exists in this country. It seems to me that we should not consolidate debt management and monetary policy in the hands of a single agency merely because such a situation may exist in other countries. Rather should we consider whether in light of our own financial system and our own machinery for economic stabilization such a consolidation would improve the performance of our economy. I can see no evidence that it would.

Question 6. Do I understand you to suggest from your statement that you believe transfers from taxpayers to interest recipients have a net adverse effect on the economy? Why do you hold this position?

Answer. Treasury interest payments are a species of transfers which differ from other government transfer payments (such as old-age pensions) only in that they are subject to tax. Accordingly, other factors remaining constant, any increase in interest payments has an inflationary effect on the economy which we may assume will have to be offset by an increase in taxes if economic stability is to be maintained. Nearly all forms of taxation have some undesirable distorting effect on the allocation of resources or on work or investment incentives. Consequently, I believe the chief burden of the debt on the economy consists in the reduction in economic efficiency or impairment of incentives resulting from the taxes needed to prevent the inflationary effects of the interest payments on the debt. It should be noted, however, that a million-dollar increase in interest payments does not require a full million-dollar autonomous increase in taxes to prevent inflation, because the interest payments themselves are subject to tax and will not increase disposable income dollar for dollar and because only a portion of the addition to disposable income will actually be spent on goods and services.

It is the above sense that I believe that transfers from taxpayers to interest recipients have an adverse effect on the economy. For such moderate amounts of interest payments in relation to national product as we have encountered, I do not believe the burden is a serious matter, but I do think it is important enough to justify our making some effort to keep interest costs to the Treasury from rising unduly.

Question 7. You suggest at one point in your statement that a budget surplus may stimulate investment. Would you trace out for us the steps by which such a result might occur?

Answer. Let us suppose that the economy is operating initially at full employment with stable prices and (for simplicity) that the cash budget is in balance. Assume now that an increase in personal income taxes is enacted in the amount of $5 billion and that the marginal propensity to consume out of disposable income is 80 percent and the marginal propensity to save 20 percent—that is, that for each dollar reduction of disposable income consumption is reduced by 80 cents and saving by 20 cents. Thus, the increase in taxes reduces consumption by $4 billion, thereby releasing $4 billion of resources for use in expanding investment.

Total saving in the economy consists of private saving together with Government saving in the form of a budget surplus. In the above example, private saving is reduced by $1 billion (20 percent of $5 billion) while Government savings is increased by the $5 billion budget surplus. We may assume that if the $1 billion of private saving that is wiped out by the tax increase had in fact been made, it would have been put into the capital market through the direct purchase of securities by the savers or by being channeled into savings institutions (savings banks, insurance companies, etc.) which in turn would have made it available to the capital market through purchases of mortgages, bonds, or other claims. Thus, by reducing private saving the tax increase reduces the flow funds into the capital market by $1 billion. If, however, the Treasury uses its $5 billion budget surplus to retire debt by buying up its securities in the market, it increases the supply of funds to the capital market by that amount. Thus, the net effect of the taxation and debt retirement is to increase the supply of funds by $4 billion. It is important to note that the net increase in the supply of funds to the capital market resulting from the increase in taxes and the use of the resulting surplus to retire debt is equal to the value of the resources released as a result of the fall in consumption. Thus, if all of the new funds put into the capital market flow into real investment, aggregate monetary demand will be restored to its original level but the composition of demand will be changed so that $4 billion more is spent on investment and $4 billion less on consumption.

In our economy, however, it is quite unlikely under most circumstances that the injection of $4 billion into the capital market will, by itself, cause real investment to increase by $4 billion. The increase of $4 billion in the supply of funds will tend to bring about a reduction in interest rates. One effect of this will be to cause some increase in real investment as borrowing becomes cheaper; however, as indicated in answer to an earlier question, the available evidence suggests that investment is quite unresponsive to changes in interest rates. Another effect of the decline in interest rates will be to cause households and business firms to hold larger cash balances (i.e., demand deposits and currency), since a decline in interest rates reduces the cost of obtaining the convenience, flexibility, and liquidity that are associated with the holding of cash balances.

It may appear at first glance that the holding of demand deposits rather than investing in securities does not reduce the supply of funds available to finance investment, since the bank in which the deposits are held will itself be able to use the funds to expand its loans or securities. However, this view is incorrect, since if the funds had been used to buy securities or placed in savings institutions instead of being held in the form of idle demand deposits, the sellers of the securities or the savings institutions would have deposited them in banks. Thus, the supply of bank funds would be the same in any case, but the holding of idle cash would directly reduce the supply of funds available to the capital market for the financing of investment as compared with the use of the funds to purchase securities or their placement in savings institutions.

The available evidence suggests that the demand for cash balances is quite sensitive to interest rates. Taking account of the insensitivity of investment and the responsiveness of the demand for money to interest rates, an increase of $4 billion in the supply of funds might, for example, cause interest rates to drop until holdings of idle cash had increased by $3 billion and the remaining $1 billion had gone into real investment. Since the initial tax increase caused consumption spending to fall by $4 billion and the use of the funds to retire debt caused investment spending to increase by only $1 billion, the net effect would be to reduce aggregate monetary demand by $3 billion. In view of the downward rigidity of our price structure, this drop in aggregate demand would be likely to cause cutbacks in production and employment. The initial decline in production and employment would reduce income which would have unfavorable secondary effects on consumption and perhaps investment (the so-called multi-

plier effects), and when all these reactions were taken into account gross national product might decline by, say, $6 billion. The decline in income would cause saving to fall by more than the initial $1 billion drop caused by the tax increase, and as income fell tax collections would also drop so that the ultimate increase in taxes would be less than the initial $5 billion increase. Thus, the drop in income would render abortive a part of the initial $4 billion net increase in national saving.

To summarize, a budget surplus generated by increasing taxes would set resources free to be used for investment to the extent that the increase in taxes reduced consumption. Use of the surplus to retire debt would supply enough funds to the capital market to finance the investment needed to fill the gap created by the fall in consumption if all of the funds were used for this purpose, but such a result would be quite unlikely.

Even though debt retirement by itself should fail to stimulate sufficient investment to maintain aggregate demand at the appropriate level, it still might be possible to increase investment sufficiently by supplementing the debt retirement by monetary policy measures to ease credit—ie., open market purchases of securities or reductions of reserve requirements by the Federal Reserve System which would expand the supply of money and bank credit—or by schemes of incentive taxation favoring investment. However, it is by no means certain that in the short run any of these means would spur investment sufficiently. For this reason, a policy of generating budget surpluses in order to release resources for investment should be pursued with caution lest it result in unemployment and underutilization of existing productive capacity rather than increased investment and an accelerated rate of economic growth.

The above analysis is somewhat oversimplified and fails to take account of a number of complications. For example, it fails to deal with the short-run dynamics of the adjustment process, and it fails to consider difficulties that may arise out of the fact that the resources released by reducing consumption will not be the same as the resources needed to expand investment. It should also be noted that the same reasoning applies to the reduction of an existing budget deficit as to the creation or increase of a budget surplus. Furthermore, a shift of the Government budget in the direction of a surplus by reducing Government expenditures on goods and services may have effects similar to those attributable to an increase in taxes, except that in this case the added resources made available for additional investment are released from the production of goods and services for Government use rather than from consumption.

(Whereupon, at 4:40 p.m., the hearing was adjourned, to reconvene at 10 a.m., Thursday, August 17, 1961.)

REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

THURSDAY, AUGUST 17, 1961

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

The joint committee met, pursuant to recess, at 10 a.m., in room G–308, New Senate Office Building, Hon. Wright Patman (chairman) presiding.

Present: Senators Douglas (co-chairman), Sparkman, Proxmire, Pell, and Javits; Representatives Patman (chairman), presiding, Reuss, Griffiths, and Curtis.

Also present: William Summers Johnson, executive director, and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN (presiding). The committee will please come to order.

This morning the committe continues its hearings on the report of the Commission on Money and Credit.

The topic this morning is private financial institutions. The Commission's report on this subject touches on a variety of issues.

Some have to do with questions of more effective control and operation of monetary policies while some have to do with questions of equity or competitive advantages among the different classes of financial institutions.

As I indicated at the opening of these hearings last Monday, we hope to focus our attention on those questions which are important to effective operations of monetary policies for the purposes of general economic stabilization and growth.

The equity issues which involve some hot conflicts among the different classes of financial institutions can perhaps be better left to the legislative committees.

In any case, our preliminary inquiries indicated that all sides to these controversies are not yet ready to be heard. Accordingly, it would seem unfair to hear some sides to the controversies without hearing all sides.

For that reason, we hope to pass over these equity controversies at this time.

We have with us this morning Mr. J. Irwin Miller, Jr., who is chairman of the board of Cummins Engine Co., Columbus, Ind., who will present the Commission's views and recommendations.

Then we will hear comments from Prof. John Gurley.

Mr. Miller, we are glad to have you with us. You may proceed in your own way, sir.

STATEMENT OF J. IRWIN MILLER, MEMBER OF THE COMMISSION ON MONEY AND CREDIT, CHAIRMAN OF CUMMINS ENGINE CO., AND OF IRWIN BANK AND TRUST CO., COLUMBUS, IND.; ACCOMPANIED BY BERTRAND FOX, ELI SHAPIRO, AND S. E. LAUTHER

Mr. MILLER. Thank you, Mr. Chairman.

For the record, I am J. Irwin Miller, chairman of Cummins Engine Co. and of Irwin Bank and Trust Co., both of Columbus, Ind. May I express my pleasure at this opportunity to comment briefly on the findings and recommendations of the Commission on Money and Credit pertaining to the operations of private financial institutions.

Variety is the salient characteristic of our financial institutions. Some of them are chartered by the Federal Government, others by the State. Some are stock companies, others are mutuals. Some are taxed, others are exempt from Federal taxation. Some are specialized in their source of funds, some in the use to which their funds are put.

Despite their many differences, nearly all of these institutions perform one common function. They serve as intermediaries between savers and borrowers, providing the financial assets savers want and the funds borrowers want. By offering financial assets that differ in liquidity, in maturity, in yield and in risk, they attract funds from a wide variety of savers. At the same time, they make funds available to borrowers on a wider variety of terms than individual savers could if they dealt directly with borrowers.

GROWTH OF THE FINANCIAL SYSTEM

During this century the private financial system has grown, not only in absolute terms but also in relation to the economy. As the financial system has grown, it has had to adapt itself to demands for new sources of and outlets for funds. This change is evidenced not only in the increase in the number and variety of institutions and in the changing relative importance of these institutions, but in the emergency of new types of capital market instruments and credit extending techniques.

The share of commercial banks in the total assets of private financial institutions has declined, even though their total dollar assets have risen, and the character of their business has changed. The share of savings and loan associations has tended to grow. Credit unions, private pension funds, and investment companies which were nonexistent at the turn of the century also account for a growing share of the assets of all private financial institutions.

THE GROWTH OF REGULATION

Financial institutions are among the most minutely regulated businesses in our country. Financial regulation has been influenced by the desire to accomplish specific objectives such as the wide promotion of thrift, the encouragement of homeownership, the provision of small loans and control of the money supply. Another impetus to financial regulation has been the breakdown of financial institutions and markets from time to time. Financial panics were recurrent throughout

the 19th century, and in this century, during the thirties, the banking system again collapsed despite the protections supposedly provided by public regulation of individual institutions and by the creation of a central bank in 1913. Such disasters have usually been followed by legislation attempting to protect institutions, savers, and the economy from financial distress. Another force leading to financial regulation has been the existence of financial abuses.

THE UNDERLYING PHILOSOPHY OF THE RECOMMENDATIONS

In examining the financial system and the economic effects of its operations, the Commission was motivated by a desire to encourage forces that would enable the financial system to make an even greater contribution to price stability and low levels of unemployment while at the same time, contributing to more rapid economic growth.

In putting forth its proposals pertaining to private financial institutions, the Commission took the position that the paramount consideration in a regulatory system should be safeguarding both the money supply and the small saver.

The traditional pattern of financial regulation relies upon numerous State and Federal regulatory authorities. It often subjects single financial institutions to multiple regulatory authorities and preserves the domain of specialized institutions. Above all, it emphasizes safeguarding the liquidity and solvency of the individual institutions by restrictions on their investments, chartering, interest rates on deposits, and by other devices.

But as a result of our experiences, especially in the 1930's, an additional approach to financial regulation was developed in the form of measures to protect the liquidity and the solvency of the system rather than of the individual institutions. We believed that both approaches for safeguarding the financial system should be retained and strengthened.

One strand of our recommendations seeks to preserve and increase the safety of the financial system. The other strand aims at stimulating the contribution of the financial system to economic growth by providing greater flexibility of lending and investment, hence increased mobility of funds, and a larger number of alternatives available to savers and borrowers. Because the Commission believes that both purposes must be fulfilled simultaneously, it stresses the fundamental interrelationship of all its recommendations.

The Commission's recommendations are restricted to a relatively small number of institutions: commercial banks, mutual savings banks, savings and loan associations, credit unions, life insurance companies, and private pension funds. These institutions hold more than three-quarters of the assets of all private financial institutions and are the principal depositories of the country's financial savings. Since they all offer fixed dollar obligations, they are active competitors for the funds of savers.

I would like now to turn to our recommendations. I shall first discuss the changes we urge to promote economic growth and then those which we feel will contribute to economic stability.

CHANGES TO PROMOTE ECONOMIC GROWTH

It was the Commission's view that investment regulations today restrain financial institutions from directing their lending into those areas and uses where the requirements may be the most urgent. By restricting the mobility of credit, these regulations impede the reduction in interest rate differentials and the effectiveness with which urgent demands for credit are met. They tend to reduce provision for credit needs for certain classes of credit risks and diminish enterprise in and competition among financial institutions. Thus the Commission recommends that the regulatory authorities permit greater flexibility to savings banks and savings and loan associations to acquire a wider range of suitable long-term debt instruments. Commercial banks should be allowed this same flexibility in the investment of their time and savings deposits.

While these financial institutions should be permitted to change their investment practices, they would not be obliged to do so. Thus the general objective of this recommendation is to make possible more competition in the lending of funds by various institutions. The Commission recommends that implementation of this proposal should be gradual. Examining authorities would permit these changes to take place only on the basis of evidence of adequate management skill in the hands of the financial institutions that would have the opportunities to make new investments.

It further urges that certain present geographical restrictions on lending should be revised. In order to reduce impediments to lending over wider geographical areas than is currently possible, these proposals are designed to encourage a freer flow of funds over geographical boundaries now restricted by regulation.

Because the commercial banks, in their demand deposit activities, provide the great bulk of the money supply, the Commission concluded that the liquidity of these institutions might be impaired if they did not confine the assets they acquire in their demand deposit business to short- and intermediate-term debt instruments.

We believe that heavy reliance on equity investment is inappropriate for institutions whose liabilities are fixed in dollar terms. Therefore, the present general restrictions on investment in equities should be continued. However, commercial banks in the investment of their savings and time deposits, mutual savings banks, and savings and loan associations, should all enjoy the least absolute burden in the restrictions generally available to any one of them.

In order to equalize competitive opportunities, the Commission recommends that Federal charters which are now available for commercial banks, savings and loan associations, and not for savings banks, should be changed. The Commission proposes that Federal charters should be made available to mutual savings banks.

It is the Commission's view that the provisions of the National Bank Act should be revised to enable national banks to establish branches within trading areas irrespective of State lines. Moreover, we believe that State laws should be revised to provide corresponding privileges to State chartered banks. Trading areas are defined as a geographical area that embraces the natural flow of trade from an outlying geographical territory to and from the metropolitan center.

Thus branch banking may be statewide, less than statewide, or more than statewide. The task of drawing boundaries should be delegated to an appropriate governmental agency as was done in the establishment of Federal Reserve districts.

In administering the power of branch banking, the chartering authorities should prevent concentration of commercial banking business. It should give new entrants a chance to compete even if their business must be partially bid away from existing institutions. Moreover, the chartering authorities should treat the applications for new branches on a par with new unit bank applications, and should accord similar treatment to applications for new branches of nonlocal banks with that of new branches of local banks.

The Commission further recommends that Federal thrift institutions should have the same branching privileges as those recommended for national banks. State laws should also be liberalized to conform to this recommendation.

The Commission studied the question of whether interest on demand deposits, which is now prohibited by Federal statute, should be continued. It concluded that the present prohibition of special payments on demand deposits should be continued.

The present statutes authorizing regulation of interest rates on savings and time deposits for commercial banks should be revised to convert this power into the standby authority rather than continuous regulation. Identical standby power should also be available to the appropriate regulatory authorities with respect to savings bank and savings and loan association deposits. The standby authority available to the authorities should permit differentiation among types of deposits, including those of United States residents and those of foreign residents. Maximum rates of interest on time and savings deposits should be imposed only, when in the opinion of appropriate authorities, further interest rate competition for these deposits is deemed not in the public interest. When such limitations are applied, the Commission suggests that consideration be given to maintaining appropriate but not necessarily identical interest rate maximums for competing institutions.

In light of its views about the prohibition of interest on demand deposits and the granting of wider latitude for the payment of interest on time and savings deposits, the Commission expressed concern about the need for a precise definition of each type of deposit if the difference in treatment is to be equitable. The definitions for time and savings deposits are less specific than the Federal Reserve Board's definition for demand deposits. It therefore urges the authorities to distinguish between time and savings deposits, on the one hand, and demand deposits, on the other, in an unambiguous manner.

In further pursuit of its desire to achieve equality of competition, the Commission recommends that the existing statutory requirements for reserves against savings and time deposits in commercial banks should be repealed. It argues further that such reserves are not necessary. Pending repeal of such requirements, commercial banks and competing institutions subject to this requirement should be permitted to hold the required reserves in the form of either cash or Treasury securities with maturities up to 5 years.

CHANGES TO PROMOTE ECONOMIC STABILITY

The recommendations just discussed emphasize institutional flexibility and equality of competitive opportunity. I shall now turn to proposals designed to strengthen the liquidity and solvency of the financial system and to foster responsibility to match the greater flexibility.

The Commission recommends that Federal deposit insurance for all savings banks and savings and loan associations should be available from the Federal Savings and Loan Insurance Corporation and that State chartering authorities should urge such participation among institutions chartered by them.

The basic source of liquidity for individual financial institutions normally should be the provision made in their loans and investments. A major function of the Federal Reserve System is the provision of liquidity for the commercial banking system. It appears desirable to make provision for liquidity for mutual savings banks and savings and loan associations in the event of needs in abnormal circumstances. The Commission recommends that membership in the Federal home loan bank system be made more attractive for all eligible thrift institutions.

These recommendations involve substantial changes in the concept of operations of the Federal home loan bank system and they should be considered with the specific recommendations concerning this system that will be discussed this afternoon by Mr. Rockefeller when he reports on our recommendation relating to the Government lending agencies.

The capital, surplus and reserves of financial institutions provide a cushion to absorb unusual losses that cannot be absorbed by current earnings. This cushion enables financial institutions to assume certain risks without endangering their solvency, and thus promotes both the safety of depositors and the extension of risk credit.

Capital requirements of financial institutions should be based on the amount and degree of risk of their assets. Requiring an equity cushion based on degree of portfolio risk would result in two incentives which work in opposite directions. One would be to accumulate reserve cushions to take on more risk assets. The other would be to minimize risk asset acquisition to avoid the need to increase the existing reserve cushion. Further efforts should be devoted to devising incentives which might increase simultaneously both risk taking and reserve cushions.

One attractive possibility is to design Federal deposit insurance to increase incentives to financial institutions to build up higher reserve cushions relative to their risk assets. Another possibility is to use tax incentives to promote the retention of earnings.

The present tax provisions do not provide a satisfactory method of assuring capital adequacy for the financial system. They do not apply equally to competing institutions. The application of present tax provisions to mutual savings banks and to savings and loan associations results in virtually no tax payments by them as compared with commercial banks. It is far easier to state the need for capital adequacy and for equality of tax treatment among competing financial institutions than it is to design a tax formula which accomplishes these objectives. One principal difficulty is the determination of how to achieve equitable tax treatment for mutual and for stock institutions.

The Commission recommends that commercial banks, mutual savings banks and savings and loan associations should be subjected to the Federal corporate income tax in such a fashion as to contribute to capital and reserve adequacy and to insure competitive equality to the extent that the Federal tax is a competitive factor. It also recommends that when reserves accumulated through special tax provisions are used for purposes not intended by this special treatment, they should be subjected, as now, to the full corporation rate.

The Commission's approach to regulation requires administrative as well as legislative changes. Its recommendations emphasize the similarities and diminish the differences between commercial banks and thrift institutions and at the same time they suggest a reorientation of supervision and examination.

The Commission recommends increased coordination of the examining and supervisory authorities. At the Federal level there should be only one examining authority for commercial banks. The Comptroller of the Currency and his functions and the FDIC should be transferred to the Federal Reserve System. The Commission further recommends that there should be a unified authority at the Federal level for the examination of all federally insured savings and loan associations and mutual savings banks. The activities and standards of these two Federal authorities should be coordinated with each other and with the respective State examining and supervisory authorities.

The Commission is impressed with the importance of the quality of management in the efficient operation of the private financial system in the public interest. But lacking investigatory powers, it has not dealt with the possibility of abuses under present regulations. In view of the rapid postwar growth of financial institutions, it recommends that the Congress should review the adequacy of existing legislation and that the supervisory authorities should review their existing regulations and examination procedures to insure against any unwarranted personal benefits accruing to individuals responsible for handling institutional funds which might be associated with or derived from the use or investment of the funds.

OTHER FINANCIAL INSTITUTIONS

The investment flexibility permitted life insurance companies by statute has been gradually increased since 1906, and is now greater than that available to commercial banks, mutual savings banks, and savings and loan associations, although still less than that available to private pension funds. Life insurance companies are now allowed to invest in a variety of credit, and, to a limited extent, equity instruments. But limits are set on their holdings of particular assets. Each type of asset must meet specified minimum standards before it can be acquired. The regulatory device of "leeway" or "basket" clauses which have come into use in some States during the last decade, has provided additional flexibility for life insurance companies by enabling these companies to invest up to some proportion of assets or of capital and surplus in types of assets not otherwise permitted and not specifically prohibited. These clauses afford life companies an opportunity to experiment and innovate in their lending, while at

the same time assuring protection to the policyholders of these companies. The Commisison recommends that other States follow the practice of permitting these "leeway" or "basket" clauses.

The Commission recommends that overriding Federal charters and regulation be permitted for life insurance companies which choose to secure such charters. The virtue of such a recommendation, if enacted, would be to encourage uniformity of high standards to insurance companies, if they should choose to subject themselves to Federal regulation rather than to State regulation, as at present.

Because of the specialized characteristics and the basic, voluntary self-help features of credit unions, the Commission has not made specific recommendations with regard to them.

The largest, most rapidly growing, private pension funds are the noninsured corporate pension funds handled largely by banks as trustees. The investment latitude permitted pension trusts now provides adequately for flexibility for the use of their funds geographically and among various types of financial investments. The Commission believes that, as a general principle, the trustees who invest pension funds, whether banks, the companies themselves, or others, should be guided by appropriate investment rules. While we believe that an appropriate regulatory authority should be given added responsibilities over private corporate pension funds, including the power to study and develop appropriate standards of prudent investment of the funds, we wish to clarify a point that has been widely misunderstood. The use of the term "prudent investment standards" is not intended to imply the promulgation of a legal list. The Commission chose not to use the term "prudent man rule" lest that be interpreted as being too restrictive. We were concerned, however, that the investment of the funds be separate and distinct from the other affairs of the company and of the beneficiaries.

Pension funds generally have been free of mismanagement and maladministration which would serve as a basis for legal action. However, recent studies suggest that present remedies are not adequate to deal with infractions that might occur. For this reason, the Commission recommends the exploration by the Congress of an appropriate regulatory authority to assure periodic disclosure to beneficiaries of the financial statements of these funds and to bring suit against malfeasors on behalf of the plan participants and their beneficiaries.

In concluding my comments, I would like to underscore two points. First, it is important to remember the emphasis which the Commission placed on the importance of maintaining the solvency of individual institutions as well as that of the whole financial system and at the same time of providing opportunity, giving encouragement, and establishing positive stimulation to these institutions to continue to pioneer, to offer new services as they are needed, and to be creative and experimental, within the limits set by solvency and protection of the depositors' dollar. The importance of accomplishing both aims simultaneously led the Commission to make recommendations which urge revised and centralized forms of regulation and at the same time favored freeing institutions from curbs which prevent them from competing aggressively in all communities for savings and for loans.

A second point which I would like to underscore is the fact that in earlier chapters we indicated the need for effective competition in

both labor markets and in product markets. The members of the Commission have been consistent in their belief that effectively competitive markets would enhance the productivity of our economy. Therefore, our recommendations on the desirability of effective competition in financial markets are consistent with those concerned with competition in labor and product markets.

Mr. Chairman, it has been a privilege to be permitted to make this statement.

Chairman PATMAN. Thank you, sir.

If it is all right with you, we will not interrogate you until we hear from Professor Gurley, and after we hear him, we will interrogate both of you.

We next have Prof. John G. Gurley.

Professor Gurley is professor of economics at Stanford University and a member of the senior staff of the Brookings Institution.

Professor Gurley, we are glad to have you, sir, and you may proceed in your own way.

STATEMENT OF JOHN G. GURLEY, PROFESSOR OF ECONOMICS, STANFORD UNIVERSITY, AND MEMBER OF THE SENIOR STAFF OF BROOKINGS INSTITUTION

Mr. GURLEY. Thank you, Mr. Chairman.

I am pleased to appear before this committee, and honored, too.

My name is John G. Gurley. I am a professor of economics at Stanford University and a member of the senior staff of Brookings Institution. The remarks which follow represent my own personal opinions.

The Commission's recommendations regarding private financial institutions may be divided into two classes. The first class bears on monetary policy as a stabilization technique. The second class involves equitable treatment of the various financial institutions and resource allocation problems. My comments will be directed mainly toward the first group of the Commission's recommendations.

RECOMMENDATIONS BEARING ON STABILIZATION POLICY

THE COMMISSION'S RECOMMENDATIONS

From the standpoint of stabilization policy, the important recommendations by the Commission regarding private financial institutions are that—

(1) direct Federal Reserve controls should not be extended to nonbank financial institutions;

(2) existing statutory reserve requirements on time and savings deposits in commercial banks should be repealed;

(3) present statutes authorizing regulation of interest rates on time and savings deposits in commercial banks should be revised to a standby power only, this standby power to be applied also to deposits in mutual savings banks and savings and loan associations;

(4) the present prohibition of interest payments on demand deposits should be continued; and,

(5) reserve requirements against demand deposits should be continued.[1]

I shall argue that, as a whole, these recommendations would reduce the efficiency of monetary control, and that the bases for the recommendations are faulty, questionable, or, in some cases, not stated.

GENERAL COMMENTS

The purpose of monetary policy is to control the liquidity of the economy, and by controlling liquidity to influence employment, output, and price levels. The time-honored method in this country for achieving this aim has been through Federal Reserve control of bank reserves and the money supply. It used to be true that when one said "the money supply," for all practical purposes he was also saying "total liquidity."

At the turn of the century the money supply was a major proportion of all liquid assets in the economy. But, for some years now, money has been on the skids, getting smaller and smaller relative to the whole pool of liquidity. This has great significance for monetary controls, because these controls have been operating on a shrinking base. It is, of course, more difficult to control the whole mass of liquidity by regulating the size of a diminishing component of it.

The Commission's report does not adequately show the extent to which monetary controls have been applied to a relatively declining area of finance. The reason for this inadequacy is the report's piecemeal treatment of the subject. The growth of private financial institutions is treated in chapter VI; the development of Federal lending agencies is discussed in chapter VII; the Federal debt is taken up in chapter IV.

Nowhere in the report is there an integrated view of the vast changes that have taken place in the financial structure during the past several decades. The financial world of the economy is an integrated world of financial assets, markets, and institutions. And the control of employment, output, and price levels through this financial world can hardly be discussed with intelligence if the financial structure is segregated into dozens of little pieces, precluding any unified view of it.

The figures in table 1 portray the shrinking base for monetary controls. In 1900 the money supply (excluding time deposits) constituted 50 percent of all liquid assets in the economy. By 1929 this proportion had fallen to 31 percent, and recently the figure was down to 25 percent. Broadly speaking, the same diminution in the base shows up when time deposits are included in the money supply.

[1] These recommendations, in the order listed above, are found on pp. 81, 169, 167–168, 167, and 68. With respect to the standby power on the regulation of interest rates, the Commission also recommends that there be differentiation between deposits of U.S. residents and those of foreign residents. (All page number references in the footnotes to Professor Gurley's statement are to the C.M.C. report.)

(Table 1 referred to is as follows:)

TABLE 1.—*Bank deposits and currency in the pool of liquidity,*[1] *1900, 1929, 1960*

[In billions of dollars]

	1900	1929	1960
Demand deposits (adjusted) and currency	5.9	26.4	144.5
Time deposits in commercial banks	1.1	19.2	71.4
Other savings deposits and shares	2.6	15.5	104.2
Policyholders' equities in life insurance companies	1.6	14.5	112.5
Federal Government securities held by the public	.6	10.0	134.5
Total liquid assets	11.8	85.6	567.1
As a percentage of total liquidity:			
Money supply (excluding time deposits)	50.0	30.8	25.5
Money supply (including time deposits)	59.3	53.3	38.1

[1] There is no standard definition of liquid assets. However, although one can rearrange, add, and subtract items, the net result is simply to change the dimensions of the picture without blurring the shrinking place of commercial banks in it. The fact always stands out that the monetary authorities have been operating on a diminishing segment of the liquidity pool.

Can the relationships among the sluggish growth of money, the relatively rapid expansion of other financial assets, and the traditional base for monetary controls be purely accidental? No. The expansion of other highly liquid assets, at times so rapid as to threaten the stability of the economy, prompted the monetary authorities to clamp down on the one asset they could directly control—the money supply. The screws were tightened on commercial banks and the money supply to compensate for increasing liquidity elsewhere. Moreover, when borrowers were blocked at the doors of commercial banks, they turned to other financial institutions, and this added pressure stimulated the growth of these institutions. The result has been a diminishing role for money in the liquidity pool, and a relatively declining role for commercial banks within the family of private financial institutions, as the Commission's table 3, on page 155, clearly shows.

In view of these developments, I cannot agree with the Commission's conclusion that it is only necessary to regulate demand deposits and currency in order to have adequate control over the liquidity of the economy.

THE QUESTION OF CONTROLS ON NONBANK INSTITUTIONS

The Commission recommends that direct Federal Reserve controls should not be extended to nonbank financial institutions, such as savings and loan associations and mutual savings banks. The reason given is that in no important sense are these institutions responsible for unwanted changes in the income velocity of money, either in the short run or in the long run.

The evidence given for the short run is that during boom years there is not much shifting by households from demand deposits to claims on nonbank financial institutions, and so the velocity of money does not increase for that reason. If anything, it is stated, such swings of funds occur during recessions. Therefore, the activities of these other institutions are likely to help monetary policy rather than hinder it.

The velocity increases that do occur during booms—

according to the Commission—

have other causes, principally the shift of corporate balances into earning assets and the reduction of household balances, to purchase goods and services.[2]

The Commission's thesis is that nonbank financial institutions have not speeded up velocity in boom years because there is no evidence that the public has shifted funds to them at such times. Rather, it is argued, the public has shifted out of money directly into goods. It is really surprising that the Commission failed to see the relation between the reduction of money balances by the public to purchase goods during booms and the prior accumulation of liquid claims on nonbank financial institutions. The public has accumulated vast amounts of these claims, especially during recessions, and such accumulations have enocouraged it, during boom periods, to reduce its money balances in order to purchase goods and services.

Thus, the willingness of the public to reduce money holdings to finance a boom has been heavily dependent on prior accumulations of nonmonetary liquidity. The almost unlimited access that the public has had to nonmonetary liquidity during the postwar years has raised velocity during the boom years of 1950, 1955, and 1959. This is the connection between the growth of nonbank financial institutions and velocity increases during the booms.[3]

With respect to the long run, the Commission states that money substitutes have probably played "some role in secular velocity movements, but not an important one."[4] The Commission notes that there is disagreement over this point; it presents no new evidence one way or the other, but nevertheless reaches the conclusion that the extension of controls over nonbank financial institutions is unwarranted.

These conclusions on liquidity and nonbank financial institutions are unconvincing because they are based on insufficient evidence, or at times, no evidence at all. They are also unconvincing for another reason, namely, that the Commission's views on how liquidity affects the efficiency of monetary controls are contradictory.

For example, at one point the Commission states that liquid assets, in the form of Federal Government securities, increase the effectiveness of monetary policy. When commercial banks sell Government securities during a boom to expand their loans, the report states, this helps to spread the effect of monetary restriction.[5] This comes as close to being nonsense as it can. What would be the situation if the banks did not have the Government securities to dispose of during a boom? They would obviously find it more difficult to make new loans. The potential borrowers would then seek funds from other sources, which would spread monetary restraint rapidly around the economy. The very fact that banks hold large amounts of liquid assets which can be sold during boom periods to accommodate loans to customers reduces the effectiveness of monetary restraint.

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[2] P. 79.

[3] More precisely, the money-GNP ratio has depended on levels of interest rates and on levels of nonmonetary liquidity. The money-GNP ratio has declined during the postwar period partly because of the rise in interest rates and partly because of the continued accumulation of nonmonetary liquidity.

[4] P. 80.

[5] P. 48.

As I say, the Commission denies this obvious fact. But it also accepts it. It is noted that when Treasury securities are sold by financial institutions during periods of economic expansion there is a rise in the income velocity of money, which counters a monetary policy of restraint.[6] This is exactly the opposite of what was previously stated. And again:

When banks restrict their lending to customers—

the Commission says—

some of those unable to obtain credit from banks seek it in other markets; this reinforces the rise in the general level of interest rates.[7]

Can monetary restraint be reinforced when banks restrict their lending to customers and also when they do not have to restrict such lending? Is liquidity in the economy beneficial to the monetary authorities and also a hindrance? The Commission wants it both ways.

There is no doubt that large amounts of liquid assets floating around the economy delay the effects of tight monetary policy, and this is appreciated by the Commission itself when it states:

When banks hold a large amount of relatively short-term securities, and have excess reserves, when other lending institutions have comfortable liquidity positions, and when individuals and businesses hold a substantial amount of idle cash and liquid assets, then a policy of monetary restraint will not affect credit extensions for some time.[8]

What a fine description this is of the postwar inflation. Banks have held large amounts of liquid assets; other lending institutions have been liquid; the public has held sizable accumulations of liquidity. For these reasons, as the Commission recognizes, monetary policy has been slow in restraining the periodic spending booms. The large pool of liquidity, continually replenished just beyond the reach of the monetary authorities, has weakened the impact of monetary restraint. In the words of the Commission, under such conditions "monetary restraint will not affect credit extensions for some time."

What should be concluded from this analysis? If you didn't already know, I would ask you to guess so that I could astound you with the actual conclusions of the Commission—that controls should not be extended to other forms of liquidity, that existing controls on time deposits should be removed, and that exclusive reliance should be placed on controlling the money supply.

As a final point on this subject, let me note that the Commission wants to require all insured commercial banks to be members of the Federal Reserve System. Why is this? Because nonmember banks are permitted to escape from the influence of monetary policy.[9] By this standard, savings and loan associations, mutual savings banks, and other financial institutions should be included in the recommendation. But the same standard is not applied by the Commission.

THE QUESTION OF DEMAND AND TIME DEPOSITS

The Commission correctly states that time deposits in commercial banks are tending to become more and more like demand deposits,

[6] P. 101.
[7] P. 49.
[8] Pp. 56–57.
[9] P. 77.

and that savings deposits in nonbank financial institutions are quite similar to time deposits.[10] That is, the whole range of financial assets in deposit form is becoming more homogeneous. But nowhere in the report is this fact allowed to affect policy recommendations. For policy purposes, it seems, demand deposits are as different from time and savings deposits as night is from day.

Let us see how this schizophrenia affects the policy recommendations. Demand deposits are to be controlled, but not deposits in nonbank financial institutions; demand deposits are subject to reserve requirements, but not time deposits in commercial banks; interest is prohibited on demand deposits, while interest on time deposits is encouraged; demand deposits are to be invested in a narrow range of securities, while time and savings deposits are permitted much greater flexibility.[11] Are these policy recommendations based on the Commission's statement that "time and savings deposits * * * are tending to become more and more like demand deposits"? It is impossible to take these recommendations seriously when they are divorced so completely from their factual base.

It is also impossible to take them seriously when they are unsupported in any way. Take the case of the Commission's recommendation that no interest be paid on demand deposits. One truly amazing thing about this recommendation is that not a solitary reason is given for it. Moreover, the recommendation is inconsistent with other views of the Commission, such as its argument for free markets and its general willingness to trust the judgment of bankers. Finally, no reason is given by the Commission for opposing interest on demand deposits while at the same time tolerating "special services" by banks in lieu of interest.

The recommendation for removal of reserve requirements on time deposits is based on the prudence of bank management in providing adequately for liquidity without formal reserve requirements.[12] This sounds like banking theory of a couple of generations gack, when it was widely believed that the basic function of reserve requirements was to provide liquidity to the banks. It is now recognized that these requirements have the essential function of controlling deposit-creation and bank lending. Let us grant that bankers can be trusted to provide their own liquidity. Even so, perhaps we should not remove controls from time deposits because (1) it would weaken stabilization policy. Further, perhaps we would not want to remove these controls because (2) it would lead to an undesirable redistribution of earnings from Federal Reserve banks to commercial banks. These considerations are more important than the one seized upon by the Commission, but they aren't even mentioned.

With respect to (1) stabilization, the removal of reserve requirements on time deposits, along with allied recommendations on demand and time deposits, would be certain to increase the difficulties of the monetary authorities in making credit restraint stick. During a boom, bank depositors would have increasing incentives to shift funds from demand to time deposits, as interest rates rose on time deposits and remained at zero on demand deposits. With no reserve requirement on

[10] Pp. 167–168.
[11] Pp. 161–162.
[12] Pp. 168–169.

time deposits, banks would have increasing incentives to encourage such shifts, in order to free reserves so that more loans could be made to demanding customers. The result would be sharp increases in time deposits, followed by an upsurge of bank loans and the replenishment of demand deposits. This would create terrific slippage in monetary controls. Banks would have maximum incentives to disguise demand deposits in the time category. The understatement of the year is the Commission's warning that such a situation would require "a precise definition of each type of deposit if the difference in treatment is to be equitable." [13]

With respect to (2) the division of earnings between Federal Reserve banks and commercial banks, the removal of reserve requirements on time deposits would raise bank earnings and lower those of the Federal Reserve. This could be offset if reserve requirements on demand deposits were raised at the same time, but this would increase difficulties with stabilization techniques, along the lines just noted. These problems are not insolvable, but solutions ordinarily come after one realizes what the problem is. I recommend a study of this problem to the Commission.

OTHER RECOMMENDATIONS; OTHER COMMENTS

The Commission is in favor of allowing private financial institutions to purchase a wider range of debt and equity securities, and of liberalizing branching privileges to national banks and to federally chartered mutual savings banks and savings and loan asociations.[14] These liberalizing changes have brakes and safety valves attached, for the Commission recommends that institutions be given greater access to liquidity in times of emergency; that there be increased coordination of examining and supervisory authorities; that institutions be encouraged to become federally chartered; and that deposit insurance be expanded.[15] Also the Commission recommends that other people work out an equitable income tax on commercial banks, savings banks, and savings and loan associations.[16] I believe that these recommendations move in the right direction, or at least point that way. It seems to me that, if adopted, they would improve resource allocation and at the same time increase the protection of the financial system from economic disasters.

There are a few comments, however, that I would like to make on some of these recomendations and on other aspects of the chapter.

With regard to income taxation of these institutions, the Commission should have pointed out that the present arrangement, whereby savings and loan associations and mutual savings banks pay almost no tax at all, affects not only capital adequacy of the institutions but also the allocation of resources and the effectiveness of monetary policy. The 12 percent reserve provision is a major factor underlying promotional activities of savings and loan associations. It is behind the gifts of coffeepots and cookbooks, the bonuses to money brokers, their high interest rates to depositors. It provides a marginal return to expansion that permits high marginal costs of expansion.

[13] P. 168.
[14] Pp. 161–167.
[15] Pp. 169–175.
[16] P. 173.

Also in this connection it should be pointed out that the question of capital in these institutions involves much more than the matter of income taxes. For example, the amount of bank capital depends on bank earnings, and these depend partly on whether the Federal Reserve allows for monetary growth through reductions in reserve requirements or through open market purchases; partly on interest rates that banks are allowed to pay to depositors; partly on the locus of monetary restraint, whether on commercial banks only or on other institutions as well. The Commission gives such a partial view of the bank capital problem that it is practically useless.

Finally, I would like to note two topics that the Commission failed to discuss, topics that I would consider essential to any understanding of financial institutions and their economic effect. First, almost nothing is said in the report about mutual funds and the stock market. The stock market is one of the most important parts of the financial system, having great bearing on spending decisions around the economy and on resource allocation. It is inconceivable that any group could have studied our money and credit system without looking at this institution.

Second, the Commission made no attempt to analyze the cyclical and secular movements in net issues of debts and equities from households, business firms, and Government units. In some years, these primary security issues have constituted only 3 percent of gross national expenditures; in other years, the proportion has risen to 14 percent. At times, primary security issues have been composed predominantly of mortgages and consumer debt; at other times, they have been heavily weighted with Government issues. Each of these constellations makes a difference to the amount of financial intermediation taking place, and the pattern of that intermediation. The growth patterns of financial institutions are not fortuitous; they are closely related to the volume and composition of these debt and equity issues. One simply cannot grasp the development of financial institutions, either in the short run or in the long run, without tackling this subject. That is a major reason why the Commission has failed to say anything really interesting about private financial institutions.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Now, Mr. Miller, if you and your staff, you and anyone whom you desire to accompany you, will return to the table, we will question you two gentlemen, if you please.

May we have an understanding that obviously we will not get to the questions—we will not get to question the witnesses as much as we would like to, but any member of the committee may expand on his remarks by inserting anything that he considers germane in the transcript.

I will ask the clerk to call my attention to the expiration of 10 minutes. We will go around 10 minutes at first. if it is all right.

I would like to ask Mr. Miller some questions, but I want to comment on some things first. I notice that Mr. Miller commented about the services of the commercial banks and about other financial institutions, indicating that probably the other financial institutions have taken over much of the business that belonged to the commercial banks.

I am not sure that he has intended to convey that point.

But what I am getting at is that I cannot understand, Mr. Miller, why your Commission that had so much money and was able to get such fine help all over the Nation, unlimited resources, that you did not first take up the question of why the number of commercial banks, has been reducing so rapidly. Forty years ago we had 31,000 commercial banks in the United States. Today we have 13,565, I believe it is.

It occurs to me that if the commercial banks had used vision and had been looking after the public interest just a little bit, that we would have had several times as many commercial banks, and we would not have all these other competing organizations.

In other words, we probably would not have a need for the credit unions or the savings and loan associations or the mutual savings banks or the finance companies and Government lending institutions, if the commercial banks had permitted more charters to be granted.

Would you tell me why you did not look into this shocking change of the reduction of commercial banks, Mr. Miller?

Mr. MILLER. Mr. Chairman, my reply, if you will understand it, will be a personal one.

Chairman PATMAN. I understand.

Mr. MILLER. Because I am quite interested myself in this subject.

Chairman PATMAN. Yes, sir.

Mr. MILLER. I am a resident of a small country town and am a county-seat banker myself and have seen some of this go on.

I can quite agree with you that the commercial banks, starting back as far as 100 years ago, should have been more aggressive to serve the growing needs that arose.

I do not feel, however, that the numerical number of separate bank institutions would have changed, because this phenomenon, reduction in number and growth in size, is taking place in almost every form of industry and service today as our country is growing larger.

While the number of separate banks is declining, the number, and availability of banking facilities and service has multiplied.

Chairman PATMAN. Now wait just a minute. Even counting the branches, the number is greatly reduced.

Mr. MILLER. May I ask my staff if there are any figures on that?

Mr. FOX. I have the approximate figures here.

Chairman PATMAN. I have not got time to go into that. Put it in the record.

Representative CURTIS. I would like to know, if you have it right there.

Chairman PATMAN. Do it in your time, if you do not mind. I have another point I want to bring up and my time will soon expire.

Representative CURTIS. I will yield a minute of my time to get the figures.

Chairman PATMAN. Go ahead and give the figures. I have the figures from the FDIC report for the record.

(The table referred to is as follows:)

Number of banks and offices, Continental United States

1859–96		1896–1934		
Year	Number of banks [1]	Year	Total offices	Number of banks (midyear) [2]
1859	2,829	1896		12,112
1860	3,051	1897		12,079
1861	2,905	1898		12,163
1862	2,778	1899		12,459
1863	2,853	1900	13,172	13,053
1864	3,016	1901		14,054
1865	3,696	1902		15,112
1866	4,013	1903		16,433
1867	4,183	1904		17,659
1868	4,308	1905	19,117	18,767
1869	4,258	1906		20,407
1870	4,491	1907		21,986
1871	5,089	1908		23,161
1872	5,374	1909		23,734
1873	5,680	1910	25,699	25,151
1874	5,994	1911		25,815
1875	6,087	1912		26,472
1876	6,125	1913		27,285
1877	6,256	1914		27,864
1878	6,136	1915	28,802	28,017
1879	6,074	1916		28,362
1880	6,110	1917		28,919
1881	6,377	1918		29,480
1882	6,825	1919		29,767
1883	7,304	1920	32,190	30,909
1884	7,757	1921	32,531	31,076
1885	7,939	1922	32,537	30,736
1886	8,366	1923	32,498	30,444
1887	9,171	1924	31,898	29,601
1888	9,606	1925	31,577	29,052
1889	10,236	1926	31,053	28,350
1890	11,055	1927	30,169	27,255
1891	11,738	1928	29,539	26,401
1892	12,006	1929	28,921	25,568
1893	12,393	1930	27,795	24,273
1894	12,196	1931	25,709	22,242
1895	12,347	1932	22,512	19,317
1896	12,324	1933	17,555	14,771
		1934	18,918	15,913

Dec. 31—	Total banking offices [1]	Number of banks [1]	Dec. 31—	Total banking offices [1]	Number of banks [1]
1933	18,402	15,363	1947	19,171	14,763
1934	19,360	16,128	1948	19,363	14,750
1935	19,395	16,023	1949	19,594	14,730
1936	19,298	15,809	1950	19,851	14,693
1937	19,162	15,556	1951	20,156	14,662
1938	19,018	15,370	1952	20,449	14,616
1939	18,889	15,196	1953	20,780	14,553
1940	18,791	15,063	1954	21,160	14,409
1941	18,757	14,988	1955	21,676	14,285
1942	18,650	14,837	1956	22,315	14,209
1943	18,740	14,740	1957	22,907	14,130
1944	18,841	14,700	1958	23,553	14,060
1945	18,881	14,713	1959	24,242	14,004
1946	18,967	14,747			

[1] Tabulations of the Federal Deposit Insurance Corporation. Data have been revised and for most years differ slightly from those published in the respective annual reports of the Corporation. For 1933 and 1934 numbers exceed those in table 15 by the number of mutual savings branches in continental United States plus the number of commercial and mutual savings banks and branches in other areas (Alaska, American Samoa, Hawaii, Mariana Islands, Panama Canal Zone, Puerto Rico, and Virgin Islands).

[2] As of January 1, 1934. Figures differ from those for Dec. 30, 1933, because of banks absorbed or otherwise ceasing operations after the close of business on Dec. 30, and because of those unlicensed on that date but approved for insurance or licensed in time to reopen on the morning of Jan. 2, 1934.

Mr. FOX. 30,000 banks, approximately, in 1920; 24,000 in 1939; then the sharp reduction to about 14,500 in 1934; and 13,500 in 1960.

But in the postwar period, the number of banking offices or branches has increased from about 3,000 to over 9,000, which would be in addition to the number of units.

Chairman PATMAN. But they are not different banks, of course; they are just branches?

Mr. FOX. Correct, sir.

Chairman PATMAN. Since you are from a small town, I want to ask you this question.

People seem to be going to the cities, principally for two reasons. If they have children, they want them educated. If they are too old, they want hospitalization and security. That will inevitably lead, if this trend continues, to a few large cities in our country, and the rest of the country, not forsaken, but almost forsaken.

You take the small towns which you mentioned. I am greatly disturbed and alarmed about the situation regarding small towns. It used to be, you know, we would have locally owned businesses and the net profits would go in the local bank and would remain there, and upon that reserve from $10 to $20 to every $1 would be issued in credit to help in the progress and development of the local community, and everything was all right. But now there are very few business opportunities left for local people. Absentee ownership has just taken all these little towns, and the money profits, net profits, no longer remain in that little town.

They go to New York, Chicago, or some other place. They do not remain there.

People are unable to get jobs locally any more after 35 or 40 years of age. The job opportunities are determined by people elsewhere, and the money making opportunities are not there.

Little towns are drying up.

Do you not see that trend as a dangerous one, Mr. Miller?

Mr. MILLER. I do see this trend happening, and I also see how it is reversed in individual communities. It is reversed in my own community.

Chairman PATMAN. How far away are you from a big city?

Mr. MILLER. We are 40 miles from Indianapolis, and that is about a 40-minute drive over a four-lane, limited-access road, and the tendency is for the ladies to go to Indianapolis to shop, but the answer to this tendency is to be found in the presence of aggressive individuals in the local community.

In my town we have been able to preserve home-owned industry. Our own bank has made a point of saying:

> There is no service that anybody in our town can get in New York that we are not going to provide here.

Chairman PATMAN. You mean in the way of credit?

Mr. MILLER. Yes, any kind of credit service.

Chairman PATMAN. That is wonderful. I am glad to hear that.

Mr. MILLER. We have arranged to do it, and by and large, business, therefore, stays in Columbus. In fact, some business from outside communities that normally went to Indianapolis has come there. This problem can be solved by vigorous enterprise on the part of individual citizens.

I have seen merchants hold their trade by giving better service than is found in the big city, and I have seen them lose it by performing minimum services.

Chairman PATMAN. I am glad to know that your bankers are so aggressive and public spirited.

Mr. MILLER. In our little town of 20,000 population we have no fear of the competition of the big merchants or the big banks whatsoever. We welcome them.

Chairman PATMAN. Or the absentee owners?

Mr. MILLER. No, we welcome them.

Chairman PATMAN. You can meet that competition?

Mr. MILLER. Yes.

Chairman PATMAN. I can see where you can. Local owners can whip these absentee owners if they have sufficient purpose.

Mr. MILLER. And it is within the power of the local community to do this, if it wants to.

Chairman PATMAN. That is right.

I think there is a lot to what you say there. In fact, I know there is.

Now, in your statement you want to continue the law that makes it a violation of the law for banks to pay interest on demand deposits. I can hardly understand bankers, of all people, they are against regimentation, and this is regimentation of the worst sort.

This is saying to a banker:

"You cannot under the law, it is unlawfully to do it, in a trade or contract with the customer, to pay him interest on that deposit, although that deposit is worth something to you." It looks to me like the bankers would be fighting that as regimentation, but the bankers are for it. They want to continue it. It is very profitable to them.

But I notice also that you refer to the fact that:

> They tend to reduce provisions for credit needs for certain classes of credit risk and diminish enterprise in and competition among financial institutions.

Now, you were pressing the point that we should have competition among financial institutions. You are pressing the point for competition at one place, and at another place saying you do not want competition at all. How do you reconcile that, Mr. Miller?

Mr. MILLER. Mr. Chairman, in this manner, there are always competing needs. In some areas it is more in the public interest to serve one need ahead of another.

In another area it might be reversed.

In the case of demand deposits, which constitute most of our money supply, we consider that the preservation of the liquidity of these demand deposits overrides other considerations. Now, there is a cost to handling every type of deposit that a bank has, and there is a margin between the price that you get for it and the cost. Demand deposits must be maintained liquid; they must be invested only in short- or intermediate-term paper, the return on which is one of the lowest in the market.

Chairman PATMAN. That is a good reason for a reduced price, but not for no price at all, as I see it. I wish you would comment on that.

My time has expired. I will have to wait. Mr. Curtis is next.

Representative CURTIS. Thank you, Mr. Chairman.

I think I will start with Dr. Gurley, if I may, because your paper is more in the broad brush which I am primarily concerned with, and

then I would like, if I get time, to return to you, Mr. Miller, on some specifics.

First, Dr. Gurley, let me say I deeply appreciate your paper and the questions you have posed, because it makes me feel a little better, having gone through this report on money and credit and feeling that I had not come to grapple with what I thought were necessary factors in order to reach these further conclusions.

I am not sure that if I had all of these things I would have come to the same conclusions that you might have, but at least I felt that we were not grappling with some of the basic issues that are bound to exist in monetary policy.

You conclude your paper on a note which, I think, is one of the essential features in monetary policy, the amount of debt of governmental units in relation to the other debts and the questions I have asked other panelists in this factor of the Federal debt are, in particular, how it fits in here and how we evaluate it.

I will come back to another question and then turn it over to you.

To get my own preconceived notions before you, I have always taken the position that our monetary policy should be as neutral as we can make it. In other words, neutral to this extent:

The amount of money should relate to our economic growth, whatever our economy has grown to. And it should be our attempt to evaluate that growth that determines monetary policy and not to affect economic growth through it, or affect employment or unemployment through it, except insofar as providing stability will create those things. And then, again, on the tax policy, that aspect of fiscal policy, too, should be neutral.

In other words, as our method of getting revenue, it does have an economic impact, but, to the extent that we can, keep the impact neutral rather than deliberately use it as we can.

Then coming to the third area of governmental expenditure, there is where we definitely are in the policymaking area, and, in my judgment, should be. And we are in a policymaking area in two ways:

First, in the details of these expenditure programs, but secondly in the aggregate, the total amount of Federal expenditures in respect to—and this is the question that I pose—in respect to what? Should it be related to a percentage of gross national product? Or does the mere size—assuming that we are going to finance this through deficit financing which will increase the Federal debt, instead of taxation—the Federal debt become important to monetary policy because of its percentage of GNP in a given year? Or is it important because of its aggregate size, the mere managing of the debt as it relates to the questions you have raised?

Would you comment on that aspect first?

Mr. GURLEY. In your definition of "neutrality," I think I quite agree with you so far as the tax system is concerned. I would hope, however, with respect to monetary policy that something more could be done with it than just to keep it neutral in your definition of "neutrality."

Representative CURTIS. Of course, there is a great school of thought that disagrees with what I regard as the neutrality theory.

I think—and I hope I am not misquoting or misunderstanding him—I think the Chairman of the Federal Reserve Board, Mr.

Martin, expresses the neutrality theory. He says that they try to increase the money or keep the money supply in step with the economy and lean with the wind or against the wind as they try to evaluate how the economy is growing.

Now, because there is this band of policy decision involved in there, and you are relating it to growth, it, perforce, does have an effect on growth, it does have an effect on employment, but the purpose is not there, if you follow me.

Mr. GURLEY. Well, I would think that Mr. Martin's phrase of leaning against the wind imply something more than neutrality. That is, it would imply an overt attempt to guide the economy with respect to price, output, and employment levels.

Representative CURTIS. Let us take the expression, because in examining it, maybe we can determine this.

I think what he really means is that the winds are this way and if you do not lean against them under the economic pressures, that you will get more money into the economy than the economy can properly absorb it its state of growth. And, contrariwise, you expand, again relating it to the economic forces, to try to relate it as best human beings can to what really is going on in the economic field. So it is not in the area of purposes where I think the difference lies. It does affect these things, but the purpose is to maintain price stability, and through maintaining that, to help us in the field of employment and in the field of economic growth. But I know that there is a wide difference of opinion with the school that really believes we should use monetary policy more forcefully and in this there is a great gradation.

Mr. GURLEY. I think that even today, Mr. Curtis, the objective is not solely price stability. There are probably long discussions going on within the Board of Governors as to how to reconcile the two aims of price stability and full employment. And so they always have their eye on both of these objectives, and at times they might well sacrifice a little bit of price stability in order to get more employment.

Representative CURTIS. I know there are people in the Federal Reserve System who, of course, have that viewpoint, which is opposed to the theory of neutrality.

But if I understand Mr. Martin's viewpoint, it is not to do that, but specifically to resist the tendency, and to keep the eye on one thing alone—price stability—on the theory, as I again state, that that is the best way in the long run to encourage economic growth and to attain maximum employment. But within the range of this thing, and because of the ups and downs of economic forces, with forces pulling in different ways, you have your eye toward those things; but the ultimate objective, as I understand the neutrality theory, would be merely trying to get out where the difficulties could be. Because in this money and credit study, I saw no one who seemed to advocate this philosophy of neutrality that I have, or think I have, in this area I wanted to direct your attention to it.

Let be go on to another question and an underlying one in your criticism of the study.

You choose to relate this monetary policy to the problem of liquidity, but the thing that I am interested in, and I want to ask you about:

What part, though, does money, as traditionally defined, play in this field of liquidity, and does not money itself in its traditional definition really vitally affect these other forms of liquidity? I agree with your exposition that they exist and there are more of them today, and the interplay of money on those near-money economic things becomes important. But suppose the Commission felt that money, as traditionally defined, had such an impact on these other forms of liquidity that you could still implement the policy.

That could be a consistent theory—I am not saying that it is—but it could be; could it not?

Mr. GURLEY. It could be, yes, except that if we look at the report, I think we would have to come to the conclusion that the Commission really does not feel that way, because it does state that when there is a lot of liquidity in the economy, in the hands of commercial banks, when nonbank financial institutions are liquid, when consumer households and business firms are liquid, then monetary restraints takes hold only after a longer period of time than would otherwise be necessary.

Now, in its own words, then, there is this slippage in monetary restraint through the control of the money supply when a lot of liquidity exists in other forms.

Representative CURTIS. I am sure that I agree with you on it, and the main thing—I see my time is up—is that I wish more effort had been devoted to the way traditional money does effect these other forms of liquidity, because it would give me a better understanding, at any rate, of what these forces might be.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Chairman, I have followed the discussion and the questioning with a great deal of interest. As a matter of fact, when this report first came out and I looked at the makeup of the Commission, I wondered how they ever succeeded in coming to the recommendations that they did, or to any recommendations.

May I ask this, Mr. Miller: Was the Commission unanimous in these recommendations?

Mr. MILLER. Senator Sparkman, I think that, with as many vigorous individuals as there were on the Commission, the degree of assent and dissent varied. If the degree of dissent was sufficient to cause a member to write a footnote, he did so.

The fact that he did not write a footnote, in general, meant either that he thoroughly agreed or that his disagreement was, in his opinion, not sufficiently strong to justify his writing it.

I think that the length of time which the Commission spent in exploring its frame of mind in coming to a consensus was a factor in producing a rather remarkable result: no one dissented from the report as a whole.

Obviously, no one could compel any of the members of this Commission to do anything. Nevertheless, assent was achieved with areas of strong dissent clearly set out in the report.

Senator SPARKMAN. I was interested in the question that the chairman put to you awhile ago about the decrease in the number of commercial banks. I notice that a great decrease came in the time of 1929 until 1934.

I believe that was the breaking date. I believe you gave it. That was the breaking date, as I recall, and that was really the time, that was during the depth of the depression that they went out, and simply never came back. Is that it?

I wonder, too, if the economy of the country has not been better served by the diversity of financial institutions that has arisen somewhat in competition with one another than perhaps it would have been had we relied upon the commercial banks to do the job.

I agree with what the chairman says or what he implies. It seems to me the commercial banks have perhaps been too rigid and have not spread out and engaged in activities that they might have engaged in or have carried on the kind of aggressive program that Mr. Miller indicated in his hometown.

But, too, I wonder if that has not perhaps caused the rise of diverse organizations such as the savings and loan associations, the great growth of the savings and loan associations, mutual banks, credit unions, the use of pension funds, participation by insurance companies in fields that banks might very well have included in their activities.

I call the chairman's attention to a measure in which he was greatly interested and one of the authors just recently, the development of the small business and investment company system, which I think promises to be a very material part in financing small business undertakings throughout the country, a field that the banks might very well have been expanded in to cover.

Chairman PATMAN. Will the gentleman yield?

Senator SPARKMAN. Yes, I yield.

Chairman PATMAN. There is no difference between us on that. You see, when the public is not being served, something will come up to take the place, in other words, will fill the vacuum.

Senator SPARKMAN. Yes.

Chairman PATMAN. And small business investment companies are very much needed, I feel, for the reasons the gentleman just stated.

I feel that the savings and loans are needed, the credit unions. But the commercial banks, they have kept on to the savings business. They have held on to the savings business. I think they ought to get out of it. They have failed in it.

Senator SPARKMAN. Let me say I was not arguing with the chairman. I rather agree with him, as he stated a few minutes ago. There has been too much rigidity in the commercial banks.

Chairman PATMAN. That is right.

Senator SPARKMAN. I have noted that particularly in the mortgage field. I have been pretty closely connected with housing legislation, as has the chairman and the vice chairman, and, in fact, all members of this committee, and I have noticed back during the years the reluctance of commercial banks to get into this field even to the limited extent that they were able to. But I do not want to spend too much time on that.

I was interested in the comment made both by Mr. Gurley and Mr. Miller about the difference in taxation between the savings and loan associations, mutual banks, and commercial banks. Of course, that is one problem that we in the Senate do not have to worry about very much and unless the House acts on it, since the Constitution places

upon the House the burden of initiating tax legislation. But I believe the committee on which my friend from Missouri serves is working on that problem at the present time.

Representative CURTIS. One of the bills bears my name, Senator Sparkman.

Senator SPARKMAN. But the problem always in my mind has been: What is the proper level at which these savings and loan institutions and mutual banks ought to be allowed to maintain reserves without taxation?

I believe the law now sets it at 12 percent, is it not? Is that too high a percentage to maintain?

Mr. GURLEY. I think it is much too high, Senator Sparkman.

Senator SPARKMAN. About what figure would you approximate?

Mr. GURLEY. It is not possible to come to an exact figure, but surely something closer to 1 percent than to 12 percent is the appropriate figure, based on past loss experience, based on present day insurance of Federal insurance of deposits, based on present day Federal insurance of a good many of the assets held by institutions, and based upon the moral responsibility of the Federal Government to keep these institutions solvent in an economic emergency.

All of these factors surely suggest that something closer to 1 percent than 12 percent is the right amount.

Senator SPARKMAN. Suppose the institutions maintained that reserve level and paid the balance back to their people in the form of dividends. Then would that get rid of the tax? In other words, I take it that the tax would be only on the dividends withheld?

Mr. GURLEY. Yes, that is right. A proper expense is the dividends paid out, the dividends and interest paid out by both mutual savings banks and savings and loan associations, and if they paid all gross earnings out, there is no income and there is no tax.

There is simply no tax revenues, and I think you would have to face that fact. This is true for all sorts of businesses for tax purposes.

Senator SPARKMAN. Where is there any profit to the Government, then, if it simply compels distribution of dividends or earnings?

Mr. GURLEY. In that case there certainly would be no benefit. I would not anticipate that this would happen to any great extent. I am almost positive it would happen to some extent, but these institutions would still want to add to their general reserves and these would be after-tax dollars.

Senator SPARKMAN. I suppose those are questions that we will see answered when the bill is argued on the floor in the House.

Chairman PATMAN. If and when.

Senator SPARKMAN. If it comes before Senator Douglas' committee in the Senate, if it passes the House.

Chairman PATMAN. Assuming it comes out of the committee.

Senator SPARKMAN. I shall not take more time. My time is about up.

Chairman PATMAN. The joint committee is careful to balance the time between the House and the Senate. I first interrogated the witnesses and then Mr. Curtis, then Senator Sparkman. Now I want to ask Senator Douglas to ask questions.

Senator DOUGLAS. I have been late in coming here and I prefer to pass.

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Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. I would like to ask you, Professor Gurley, are you suggesting that a proper monetary control can be established only if you have a single, uniform control over all private and public financial institutions?

Mr. GURLEY. Almost so.

I would not go so far as to include all private nonbank institutions. I think, however, that the minimum requirement is to retain controls in the form of reserve requirements on time deposits in commercial banks.

I would consider it a very grave mistake to take off these controls.

Next, I would like to see the same sort of reserve requirements applied to mutual savings banks and to savings and loan associations.

Now, this, in my judgment, would improve the efficiency of monetary control a good deal, just to go that far.

Representative GRIFFITHS. Since you mentioned the stock market, would you bring the stock market under the same form of control, or would you leave it?

Mr. GURLEY. No.

It is not the same type of institution.

Representative GRIFFITHS. No; of course not.

Mr. GURLEY. The nonbank financial institutions' main function is to buy debts and equities from the ultimate borrowers and to issue other types of assets that are a good deal more liquid in most cases in the form of deposits and whatnot to ultimate lenders.

The stock market is an institution in the financial markets facilitating the trading of existing equities in the system, and not buying one type of security in order to issue a different type of security.

So it should be outside of this control mechanism.

Representative GRIFFITHS. Thank you.

Mr. Miller, I would like to ask you, if all of the recommendations of the commission were accepted, in your judgment, would it result in a more uniform amount of capital available for mortgages at a uniform rate of interest throughout the country?

Mr. MILLER. Mrs. Griffiths, we believe that if our recommendations were accepted, there would be a greater number of choices available to both savers and borrowers.

Representative GRIFFITHS. I did not understand you.

Mr. MILLER. There would be a greater number of choices available both to savers and borrowers, because there would be more competition both for his loans or for his deposits. He would benefit.

Possibly in the long run, from lower prices; I mean a lower cost for the service he needed.

We believe that the presence of competition would promote a more efficient and lower cost banking service and offer more services of the kind that the saver or the borrower needs.

We do not believe that this would make the whole service more uniform and less varied.

Representative GRIFFITHS. Are you not recommending branch banking?

Mr. MILLER. Yes; we are.

Representative GRIFFITHS. How, in your judgment, does this make a wider choice available to people?

Mr. MILLER. In the big cities today, the presence of numerous banking institutions and numerous branches gives excellent banking to almost all individuals. I live in a small town in the country. Many communities are so small now that they have no bank, or in many cases one or two.

Throughout this country area of our land, there is not, in my opinion, adequate banking service available in many areas to the individual depositor and lender.

The increasing of competition through the permission of branching will extend the variety of services and the competition for the saver's dollar and for his loans in a most desirable way.

I say this as a person in a community where, if these recommendations were adopted, big city banks could come right in and compete with me. I think this would be good for the individual citizens in our community.

Representative GRIFFITHS. As a banker, could you tell me the difference in the profit to a bank of making a $50 million loan to Dow Chemical as distinguished from $50 million lent at $15,000 on time on houses?

Mr. MILLER. It would be very difficult to give a 30-second answer. In the first place, this choice is available only to large banks, because only the very largest banks can make a $50 million loan.

Representative GRIFFITHS. Would a branch banking system throughout the country be more apt to have that choice available to them?

Mr. MILLER. Yes.

Representative GRIFFITHS. Than you would as a banker?

Mr. MILLER. The branch banking would bring to many communities services that are absent now.

Representative GRIFFITHS. But would it not also possibly take from the community——

Mr. MILLER. It also brings usable funds to these communities.

Representative GRIFFITHS (continuing). The $15,000 I might want to borrow and make it available in some large city at a remote distance to a large industry?

Mr. MILLER. You mean might it take that money away?

Representative GRIFFITHS. Yes.

Mr. MILLER. In practical fact, that does not occur, in my opinion.

Representative GRIFFITHS. It does not?

Mr. MILLER. No.

Representative GRIFITHS. Then you would not say that there is any possibility that the fact that the Bank of America dominates California banking has anything to do with the high cost of interest on homes in that State?

Mr. MILLER. This is a specific case, and I do not know, but I will give a personal reaction to it.

Representative GRIFFITHS. That is quite all right.

Mr. MILLER. My personal reaction—I am also interested in some retail stores in California—my personal experience has been that the presence of a large or more than one large bank with branches, in which funds flow quite freely from the northern part of the State to the southern part of the State, has enormously enhanced the growth of that State over, let us say, some other States where funds have not been so mobile.

Representative GRIFFITHS. But is the shortage of mortgage money in that State due solely to the shortage of savings of Californians?

Mr. MILLER. I am not sufficiently acquainted with the individual affairs in California to give an answer that would mean anything.

Representative GRIFFITHS. I believe that one of the people from the Commission testified to that—that that was the reason.

Now, I would assume that this Commission, on which you have sat, would have endeavored to make some suggestions which would have so changed the institution of banking in the country that in place of the funds flowing East, they would also have flowed at a uniform rate West toward the need.

Do you feel that they have?

Mr. MILLER. My impression is that, if our recommendations on branch banking by regional trade areas were adopted, there would be less centralization; that what you are talking about would tend to happen.

Representative GRIFFITHS. Would you care to comment, Professor Gurley, on the question?

Mr. GURLEY. I am hesitating because I find myself in agreement with the Commission's views on this matter, but I will go ahead and say it anyway, Mrs. Griffiths.

I agree with the Commission on this matter.

Representative GRIFFITHS. That this would be the effect, the Commission's suggestions would more uniformly disburse capital funds throughout the country at a more uniform rate of interest?

Mr. GURLEY. Yes.

Representative GRIFFITHS. And how do you think it is going to do it?

Mr. GURLEY. I think the recommendations with respect to liberalizing the types of assets that may be purchased by nonbank financial institutions and their recommendations with respect to commercial bank branching privileges, that both of those things will facilitate the flow of funds around the country, and hence tend to make interest rates more uniform around the country.

Representative GRIFFITHS. Do you think that small banks are less apt to lend on homes than branch banks?

Mr. GURLEY. I have no special knowledge of this, Mrs. Griffiths.

Representative GRIFFITHS. Are there no facts and figures on it?

Mr. GURLEY. If there are, I know of none, so I would prefer not to comment on that.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Senator Pell?

Senator PELL. Thank you.

Mr. Miller, I was particularly struck by the suggestion in your testimony that perhaps the vista of the prudent man who invests in pension funds should be broadened or at least kept broad.

I have been struck through the years with the fact that the investment patterns of most union pension funds have generally been much more conservative from the viewpoint of investment than have the investment patterns of hospitals, universities, foundations, or most investment trusts.

Along the same line of reasoning, I raised this question in the Labor Subcommittee the other day, with representatives from the Depart-

ment of Labor, and with Mr. Carey, who is the secretary-treasurer of one of the major unions. They said that in their opinion it would be a good thing if more pension funds went into the common stocks and perhaps less into bonds and investments with fixed returns.

I was wondering what your thinking along that line is, if this is not a good idea?

Mr. MILLER. Being on both sides of the question, being a banker who administers pension funds and also a manufacturer who bargains with unions to establish pension funds, I realize that there are two forces that we take cognizance of here, and it is a result of possibilities of conflict between these two that we urge some beginnings of minimum regulation.

When a pension is expressed in terms of fixed dollars, by and large, the union prefers to see the fund invested in fixed dollars, because if the pension is raised later on, unions have little concern over the costs of contributions to the fund.

The manufacturer who provides the annual payment into the fund is concerned about the return on the fund, because this affects the cost of the contribution.

Thus, in general, his interest is in a higher proportion of equities.

Now, one of the ways in which pension funds will be enabled to return adequate pensions over the years is to grow, is to attain some reasonable measure of capital growth, in addition to income, within the limits of safety and solvency.

As to the actual beneficiary himself, he has a difficult time getting heard, because he is only heard through a representative on a committee that is quite remote from him.

It is for this reason that we think there is a place for the public in here, to set some minimum limits out of concern for the interests of the final beneficiary.

Senator PELL. Right.

But in answer to the more specific query as to whether you think it would be desirable for a larger proportion of pension funds to be invested in equities than is now the case, what would be your view from the viewpoint of the national economy, Mr. Miller?

Mr. MILLER. As an individual?

Senator PELL. Yes.

As I understand it, you are here speaking as an individual in any case.

Mr. MILLER. Yes.

The Commission takes no view of this, since it is outside of their purview.

My own opinion is that the balance between equities and fixed investments at the present time is roughly appropriate to the conditions of the present day.

Senator PELL. Do you think that it is correct that they should have this more conservative investment pattern?

Mr. MILLER. The trouble is with averages. You have got some funds that are 90 percent in fixed and you have got some that are heavily in equities.

Senator PELL. I am talking about the average.

Mr. MILLER. The average, I believe, runs around 40 percent in common stocks.

Senator PELL. As opposed to, say, Harvard University which has maybe 58 or 60 percent?

Mr. MILLER. Yes.

Senator PELL. I just happened to cite Harvard—I do not have the distinction of being a graduate, as so many do——

Mr. MILLER. I am on the Yale finance committee and we battle with the same problem, and I think that this difference is appropriate.

Senator PELL. You do?

Mr. MILLER. Yes, I do.

Senator PELL. To me, it seems somewhat reminiscent of the banker's viewpoint when they are trustees, which is to avoid criticism, and so they usually tend to invest for the beneficiaries in a trust and nobody can ever criticize them, then, but it is not necessarily in the best interests of the recipients of the beneficiaries.

Mr. MILLER. In the case of a pension fund, you have to make certain that an individual man, with an individual life expectancy, at the minimum, gets what he is entitled to.

Now, it is desirable to go beyond that and make it possible for him to get a greater pension, but that consideration is very much secondary to guaranteeing that he gets what he thinks he is going to get.

This is a different consideration from, let us say, Harvard and Yale, who are institutions 200 or 300 years old and are planning much further out, and can take a beating in 10 years in order to reach for a gain in 30 years.

You cannot do that with a pensioner. He has to have his pension guaranteed and available to him on the day he retires. So you have two different considerations and, therefore, you approach them in different manners. I think, in general, if you can comment on averages, which is unwise, I think that present differences are relatively appropriate.

Senator PELL. Do you have a comment on this question, Mr. Gurley?

Mr. GURLEY. No. I have not, Senator Pell.

Senator PELL. Thank you very much.

Chairman PATMAN. Senator Douglas, since he passed before, would like to ask some questions now.

Senator DOUGLAS. I would like to pick up the point that Mrs. Griffiths touched upon: namely, the effect of branch banking upon concentration of business.

As we all know, two countries that have carried branch banking to almost the ultimate extreme are Great Britain and Canada. In Great Britain the Big Five, so-called, have virtually all of the banking. Canada, when I last looked at the figures, which was some years ago, the Bank of Montreal and the Bank of Canada dominated the entire country.

In addition, Great Britain is very different from when Walter Bagehot wrote "Lombard Street," when he spoke of the country banks.

Now, I have talked with a great many people in Great Britain and a few in Canada, and their almost unanimous opinion is that the concentration of banking led to a concentration of industry; that huge funds were accumulated, and that, as Mrs. Griffiths suggested, the natural tendency of an investment official in a bank is to lend it out in large sums, too. It is easier to do. And she suggested that

overhead cost is less for one transaction of $50 million than for a thousand transactions of $50,000.

I wondered if you have made any investigation into the branch banking system of Canada and Great Britain to see whether this sort of off-the-cuff opinion of mine is well or ill founded.

Mr. MILLER. Senator Douglas, we did discuss, at the time that our branch banking proposals were under discussion, the British system and the Canadian, and the Commission came to a unanimous approval that nationwide branch banking was inappropriate, if the needs of this country are to be properly served.

We rejected both the Canadian and the British system, and felt that the regional trade area concept would better serve the needs of this country than a monolithic system such as you have in Canada.

In Canada, I believe that this has grown up because of the extremely thin population. If you take the total population of Canada and the number of banks, I would guess that in metropolitan New York about the same number of people are served by about the same number of banks, but geographically, I think, Canada may have had great difficulty in sustaining good credit with as varied a banking system as we have, because both money and people are pretty scarce up there.

This is not true, however, in Great Gritain.

And they have, to a certain extent, mitigated the effect of this. For instance, I know that in the case of Barclay's Bank, they absorbed a family bank in Oxford. This bank, while it is an official part of Barclay's, is still run by the descendents of the family.

So, if you get down underneath the surface, it is probably not quite as monolithic as it might seem.

Senator DOUGLAS. I had some experience on the legislative end when we were working on bank merger legislation, banking legislation.

Of course, you know that in the West the Bank of America not only dominates California, but has very strong control over Arizona, and I think has about half the assets of Oregon, so that it is a regional syndicate; and the Minneapolis group, I believe Mr. Thompson was a member of your Commission, has control over a whole group of banks out of Minnesota, the Dakotas, Montana.

I have not looked at the New York figures very closely, but the Marine Midland group does very well upstate, and I guess in New York itself.

And so you have regional empires growing up.

I wondered whether you feel this is healthy.

Mr. MILLER. I would like to comment on this as a borrower myself in California.

We have never found that in any effective sense the Bank of America dominates.

For instance, I believe the fastest growing bank in the San Francisco area is not the Bank of America, it is the Pacific National which is the smallest bank.

Senator DOUGLAS. What percentage of the banking assets of California does it have?

Mr. MILLER. Enormously in favor of the Bank of America. But, nevertheless, if there is adequate choice, you do not have domination, and, as a borrower, I have found that competition is extremely severe, and that there are adequate choices, and that you are not at the mercy of the largest member.

Senator DOUGLAS. Of course, this is all a relative matter, but certainly, if you have one group having 50 or 60 percent of the bank assets, and other groups with a large nuclei of assets, it is very different from a situation which you would have when you have a broadly distributed set of banks with proportionately equal bank assets and lending facilities.

Senator SPARKMAN. If the Senator will yield, I remember in those hearings we were told in many localities not only did the bank have dominance as far as its own lending activities were concerned, but it had gotten control of industries and it had complete control of the economy of the community, is that not right?

Senator DOUGLAS. Yes, in a qualified sense.

Senator SPARKMAN. Do not qualify it too much.

Mr. MILLER. Mr. Chairman, if I can comment on that, as a customer of banks in such areas, I have not felt that type of restriction and domination.

Chairman PATMAN. I wanted to ask you about San Francisco. You state that the power of the Bank of America is lessening; that there is more competition there now and there is more business outside?

Mr. MILLER. I do not know about the trend. What I have stated is that there is a vigorous, active choice.

Chairman PATMAN. In the San Francisco area?

Mr. MILLER. And competition.

Chairman PATMAN. I believe that that is where the bank which was the predecessor of America started. Mr. A. P. Gianinni started there in San Francisco.

Now, your Commission did not make any recommendation about holding companies, did it?

Mr. SHAPIRO. Our comments on this, the merger movement and influencing the bank merger movement, are expressly concerned with and about the need for public policy to maintain competition in the banking community.

Chairman PATMAN. I do not accept that as an answer. I appreciate what you have said, but it is not an answer to my question. Did you say anything about holding companies in the report?

Mr. MILLER. My immediate recollection is that we did not.

Chairman PATMAN. The question presents itself to me that there would be no reason why, under your recommendation, if it were adopted over the Nation, that you would not have branch banks in metropolitan areas, like Indianapolis; take in your area, for 20, 30, or 40 miles around.

In the Chicago area, notwithstanding State or county lines, you would have branch banks, because the Commission believes in wiping out State lines and county lines. Then you would have metropolitan areas all over the country, say, probably 15 or 20 that would have huge branch banking systems.

What would prevent, say, a holding company in the West from having control of those branches in the metropolitan areas?

Mr. MILLER. If it tended to diminish competition, I think that the public regulatory authorities should prevent it.

Chairman PATMAN. How could they under present laws? You see, you are not recommending anything. Now, you are recommending a system which, if carried to its logical conclusion, that is, people seek-

ing an effort to expand as much as they can under existing laws, would get a hold of more banks and more banks every opportunity they have, as they are doing now.

There would be nothing, according to your recommendations, to keep one holding company from having charge of the banks of the United States of America.

Mr. MILLER. I would disagree there because we do not recommend specific legislation. We are recommending——

Chairman PATMAN. Why, you did recommend specific legislation. You recommended that we eliminate county and State lines for branch banks. That is specific.

Mr. MILLER. In a manner that would increase the competition in those areas.

Chairman PATMAN. You say increase the competition?

Mr. MILLER. This is the most important emphasis in this whole chapter. However these are accomplished, it must be accomplished in such a manner as to increase competition and choices.

Chairman PATMAN. With all due respect to the fine members of that Commission, I think it is a most disruptive thing that you could possibly recommend.

Whenever you permit a concentration of money and credit in this country, this Nation cannot prosper and develop like it could under an independent system, the way I see it.

Now, of course, I am against branch banks. I think we should have local banks run and owned by local people. I believe in that.

In Texas we have a constitutional provision, and I believe Illinois has a constitutional provision.

Senator DOUGLAS. That is right.

Chairman PATMAN. That you cannot have any branch banks. You have got to have separate and distinct banks, and they cannot even have offices in any other place except right there at their home office.

I think it is a wonderful system, myself. I wish we had it all over the Nation.

I certainly view with alarm this trend of branch banking as just taking money away from little communities and putting it in the big cities. That is the way I view it, and I think it is detrimental to the interests of, and the welfare of, the country.

I am very sorry that the Commission made such a recommendation. I think the Commission is entitled to criticism for overlooking so many things of great importance and just getting right down to trying to make a national branch banking system in this Nation.

I think the main point in this whole report is to build up and whip up sentiment for a national branch banking system.

Yes, Mr. Gurley?

Mr. GURLEY. I would like to comment on that, Mr. Patman, if I may.

I sympathize with the type of banking system that you want to see, but the trouble is that the inherent forces within the banking industry simply run counter to this.

Banking is an industry with increasing returns. The more they expand over wide ranges, the more efficient banking becomes.

Chairman PATMAN. You are overlooking the correspondent banking system.

Mr. GURLEY. I am addressing myself to branch banking now and to the inherent tendency of banks to become larger and larger, taking advantage of economies of size.

There is always a tendency for banks to become larger than they presently are on the average.

That is, they are, in large part, I believe, held back to rather uneconomic sizes at the present time.

If the most economical size of a bank means that we are going to have just one bank in the country, and it is working in the most efficient way, then the only thing left to do is to control it as a public utility.

I do not really think the solution is to hold back individual banks to small sizes where they are inefficient in their operation. This, I think, is what is being done when branch banking is discouraged.

Chairman PATMAN. I think this should be considered, too, and I think the Commission is entitled to criticism for this. You know, the banks have been going out of the banking business. They are becoming Government bond brokers and commercial bookkeepers.

You are making, I guess, three-quarters of a billion dollars a year keeping people's books, I mean service charges. And you are getting into the long-term investment business, clear out of the commercial banking business, clear out of it.

I think that you ought to get away from savings entirely and turn that over to the savings and loan and the other institutions. I think it is a bad thing.

Now, it used to be we had a charter for a bank in a little town, local people only were the only ones who could own that stock. They could not own it outside. At least, they could not have directors outside. Local people had to run that bank. I think that was a good thing.

But in recent years, they are beginning to get away from accommodating and servicing the local people in the area where they are chartered to do business. It got so bad the Government even had to set up an agency to finance the farmers. The banks would not actually make them loans.

It has been difficult to get small business loans in local areas. But the banks have been going off and investing in Government bonds, and even manufacturing money to buy long-term, tax-exempt bonds, and the banks today own about 30 percent of all the tax-exempt bonds.

Now, in my book that is bordering on immorality on two counts.

On one count, to be allowed to manufacture money at all for the purpose of buying long-term bonds.

The other count, using manufactured money to buy long-term bonds where the income is tax-exempt. That does not belong in the commercial banking business. You do not think it does, do you, Mr. Miller?

Mr. MILLER. I would like to comment that there are two dangers that the country should seek to avoid. One is overall national domination, which you have mentioned.

The other, and one that I am personally quite familiar with, is the phenomenon of local bank domination. There are many communities in which the locally owned bank can sit on the community's money and not put it back to work in that community.

Chairman PATMAN. I know there are——

Mr. MILLER. Our feeling is that the local banker is in a protected position and that protection is not always good, and, therefore, increase of competition in the maner that we have proposed helps to correct and control this business of potential local monopoly.

Chairman PATMAN. What you are saying is you are against these little Hitlers in these little towns?

Mr. MILLER. Or the big ones.

Chairman PATMAN. That argument is always made. But, you see, that is a pretty weak argument, I think, with all due respect to you, Mr. Miller.

That is made where there are monopoly charges in other lines of business besides banking, but it never did appeal to me. Maybe I am entirely wrong. But these local banks, they have competition. It is only 40 minutes from your hometown to Indianapolis, 40 minutes. You could not have a little Hitler there in your town because they would go to Indianapolis.

Mr. MILLER. This competition exists for the larger borrower but not so much for the smaller one.

Chairman PATMAN. Now, with good reasons and fine methods of transportation, why, that, answers your argument there pretty well.

But there is another argument. Whenever a banker becomes too conservative and he is not serving the public interest, they organize a credit union; they will organize other financial institutions, if they cannot go to some distant place to get their credit.

My time is up. Mr. Curtis?

Representative CURTIS. I had some questions of my own, but I cannot leave the record as it is on a couple of things. Just one remark, possibly facetious, but nonetheless basic. It is rather interesting to hear something other than the New York bankers "catching hell" on this talk about the development of the west coast.

I do not know whether the New York bankers would have developed the west coast to the extent they did. So to that extent, at any rate, we have had a new economic empire grow up, and being from St. Louis I am frankly very happy to know that there are powers in the country other than New York City.

I am sorry that Senator Sparkman has left because the issue is a very important one, in my judgment, involving the savings and loan bank taxation problem which is not as he stated it, but a question of whether or not growth capital shall be before taxes or after taxes.

And that runs through many other institutions, co-ops, and it would include the oil industry, too, as to whether capital really used for growth—not for protection of savers, not for replacement of capital, but used for growth—shall be before tax dollars or after tax dollars.

Now, the bulk of our growth capital is after tax dollars and if we have a differential in here that has some people having growth capital which is before the tax, why, we certainly channel money into that area.

Then one other thing I would say to Mr. Patman on the fact that commercial banks have municipal bonds:

I am glad that there is a bond market for municipals. I have had legislation in for some time on which I get no help, I might say, from the other side of the aisle to try and increase the market for

municipal bonds by extending the principal to investment trusts and other institutions, not to help any investor but to try and broaden the market.

And if the commercial banks are taking great supplies of Government bonds, I would suggest we direct our attention to stopping the increase in the supply of Government bonds that have to be marketed.

That relates back to my original questions having to do with expenditure policy and Government deficit financing.

Mr. Miller, the specific questions I had, and there are not too many, but these interested me:

You suggest at the Federal level there should be only one examining authority for commercial banks. The Comptroller of the Currency and his functions and the FDIC should be transferred to the Federal Reserve System.

I was wondering, though, what if you transferred the Comptroller of the Currency, his functions, to the Federal Reserve System, would there then be any reason why the FDIC should not be turned over into the private sector, and this is something I have long wondered, why we did not get the FDIC out of the governmental area and into the private sector?

If we took the Comptroller of the Currency and his functions out of that picture and put it in the Federal Reserve, would you comment on that?

Mr. MILLER. It would have to be a personal comment because I have no recollection that this possibility was thoroughly discussed in the Commission.

In general, we favor putting these all in one place, because they all dealt in a good percent of their work with the same matter, and there is some confusion among bankers now, caused by varying standards, different stories by different regulatory authorities, and we felt that this should be simplified to the highest standard.

Representative CURTIS. One other comment on the FDIC in relation to FSLIC. I was just astounded at the discrepancy in reserve accounts of the FSLIC in relation to FDIC, which was brought out in our hearings on taxation of savings and loans.

The figures were that the FSLIC has 67 cents per $100, I guess it was deposits, as they were comparable figures, and the FDIC is around $1.84 per $100.

Chairman PATMAN. Will you yield?

Representative CURTIS. Yes, surely.

Chairman PATMAN. 83 cents on the $100 liability, that is for all deposits, and, of course, that is the way they always determine it in FDIC. It is $1.84 for the restricted number that are specifically insured. You are correct about that.

Representative CURTIS. So you think the figure as we are relating them should be 83?

Chairman PATMAN. It is 83, if you will look it up in the book.

Representative CURTIS. I am very anxious to get it clear. You say the 83 relates to the deposits that are covered?

Chairman PATMAN. It says here the deposit insurance fund amounted to $2,222 million on December 31, 1960, or 0.85 percent of total deposits in insured banks.

That is page 23 of the FDIC report.

Representative CURTIS. What I am trying to get is the comparable figure.

Mr. Miller, would you have any comments? The figures that were given to the Ways and Means Committee, I may be off a few cents——

Chairman PATMAN. You are correct.

Representative CURTIS. $1.84 per $100, and the FDIC, 67 cents per $100, and they were given as if they were comparable figures.

I thought that both referred to the $100 of deposits which the reserve fund is supposed to cover.

What do you say that the 83 cents is, Mr. Patman? What is that a ratio of, the 83 cents to what?

Chairman PATMAN. It is the same amount as it was in 1934 when it was created. It has not increased a bit.

Representative CURTIS. What is the $1.84?

Chairman PATMAN. They have got 83 cents to cover every $100 of liability, deposit liability, in all the banks that are covered. They have got $1.84 to cover just the restricted and specific insured deposits.

Representative CURTIS. All I am trying to do is compare the figures.

Chairman PATMAN. They would like to cover them all.

Representative CURTIS. I want to compare the figures, and what I am trying to get at is the difference.

If that is true of the FDIC, it would be true also of the FSLIC, because I am sure that many savings and loans are not covered.

But their figure is 67 cents.

Your commission apparently did not get into that at all, but I wondered if you had any comments on why there should be this tremendous differentiation in reserves on two similar kinds of guarantees?

Mr. MILLER. I would rather not comment off the cuff, but we would be glad to comment for the record, if you would like it.

Representative CURTIS. Yes, I would appreciate it very much because I tried to get these answers in the hearings and the savings and loan institutions had nothing to say at all. They did not even give the explanation that Congressman Patman is supplying here, which I frankly do not quite understand yet.

One other, and this is in the nature of a comment, Mr. Miller, for your further comment.

One of our problems—I was the chairman of a subcommittee concerning taxing life insurance companies back a few years ago in the 83d Congress—is the fact that the Federal Government had over a period of years left to the States the whole area of regulation of life insurance companies.

And I think it is to a large degree true in many of our savings institutions.

Our problem at the Federal level, when we started to impose a tax or mess around with our taxes, we found that whether we liked it or not, we were interfering with or commenting on or affecting State regulations.

I felt that possibly for that reason maybe we ought to leave to the States the taxation of life insurance companies, which they do tax heavily anyway.

I was overruled on that.

But there was no observation of the Commission on the weaving in, whether we like it or not, of the impact of fiscal policy, taxation policy, on regulatory policy. That was not developed or at least I could not find the thread in there at all.

Was there much discussion of how taxes get in, willy-nilly, into the field of regulation because of the complexities?

Mr. MILLER. I think we have to discuss that only by implication, which is dangerous, but the approach that the Commission took toward life insurance companies is to be found in the implication of its recommendation of making Federal chartering available.

Representative CURTIS. That is why I commented on it, because I noted that you had made that and it is very interesting.

We have always felt that the State regulation has been pretty adequate, but it is for monetary reasons that you would suggest the Federal Government do this, the part it plays in the aggregate? Is that the reason you are suggesting it?

Mr. MILLER. I think it is for purposes of maintaining consistent standards of high quality.

Representative CURTIS. Why is not the marketplace provided in the sense that the States themselves, by having different sets of regulations, afford the flexibility?

Mr. MILLER. They afford some flexibility, but they also afford some quality differences.

Representative CURTIS. Some what?

Mr. MILLER. By and large, the State of New York sets the standards for the whole country.

Representative CURTIS. They do, but it is done more by setting a good example; in fact, that is the only way it does it, and I think that is pretty good.

Mr. MILLER. I believe our recommendation says that this is not a matter of compulsion. This is a matter of making it available.

Representative CURTIS. But, you see, if we did it—I can tell you right now—at the Federal level, it would not be long before we were really in Federal standards. We have got that problem across the board in almost everything we touch at the Federal level.

If we do it, there is the tendency then to get into the thing, and that is a perfectly good theory of government. I happen to disagree with it because I do not think it works, but that theory could be advanced.

But I suggest that I would not want to do it for monetary policy reasons. I feel that the area of Government regulation is a legitimate area for Government to set policy, doing it openly, directly, above-board, discussing the pros and cons of the policy.

One reason I do not like to use monetary policy or fiscal policy, the tax end of fiscal policy, to affect economic results, we have got the tools to do that directly.

I had a feeling that your suggestions to have Federal regulation of life insurance companies come under your ideas of helping monetary policy.

I would be willing to discuss whether they should or should not on the basis of regulations, whether we are doing a good job in regulating, but then we have to get into what the States are doing and why a Federal system would be better.

Mr. MILLER. I believe that basically it relates to our desire to increase competition and set service at a high standard.

Representative CURTIS. This high standard is the thing, because who sets the standard? I have seen codes of ethics used to stifle competition, all in beautiful sounding phrases, and I always like to look to see whether they are really high standards or whether their purpose is something else, because the market place, in my judgment, if it is a free marketplace, a real competitive marketplace, regulated in the sense that it preserves the competition brings about high standards and, in my judgment, the highest standard we could get.

Chairman PATMAN. Professor Gurley, I have some questions for you which the reporter will copy into the record, if you would not mind answering them when you correct the transcript.

Mr. GURLEY. I would be glad to, yes.

(The questions referred to are, as follows:)

QUESTONS OF CHAIRMAN PATMAN FOR PROFESSOR GURLEY AND REPLIES THERETO

Question 1. Professor Gurley, your statement suggests to me that there is a real need for an investigation of the money and credit system. Would you agree with that?

Answer 1. I believe that there is a real need for further investigation into certain aspects of the money and credit system, though many areas of this field have now been adequately covered. As I pointed out before, the Commission missed an opportunity to present an integrated picture and analysis of changes which have occurred in the financial structure during the past several decades. This is still worth doing, and once done it is likely to give us fresh insights into the working of our money and credit system.

Question 2. You have brought out an extremely important point concerning the effects of time deposits in the commercial banks and a point which is widely misunderstood.

A great many people seem to think that time and savings deposits in the commercial banks have nothing to do with money expansion and the money creating process—that only demand deposits play a role in money expansion.

I have had an opportunity, over the years, however, to question both bankers and the technical people in the Federal Reserve who keep track of the bank reserves, and they all tell me the same thing, which is:

Reserves against demand deposits and reserves against time deposits are commingled. In other words, when a bank computes its required reserves, it computed a lump-sum figure which is a weighted average of reserves against both time and demand deposits. So, if we drop the 5 percent reserve requirement against time deposits, this would automatically permit the banks to expand their demand deposits, assuming that the Federal Reserve does not reduce its portfolio of Government securities, and assuming the Federal Reserve wishes to maintain the same money supply. I wonder if it would be too much to ask that you include a couple of computations when you correct the transcript?

I would like to know by what amount the Federal Reserve would have to reduce its portfolio of Government securities if the 5-percent reserve against time deposits was dropped, assuming that the Federal Reserve wants to maintain the same money supply as now.

Then, I would also like to know what amount of Government securities the Federal Reserve would have to sell—and, in effect, transfer to the commercial banks—under the same assumptions, with this additional assumption that 20 percent of the demand deposits are shifted over to time deposits after repeal of the reserve requirement against time deposits.

Answer 2. If the money supply in your questions includes time deposits, then the answers are as follows: If the Federal Reserve maintains the same total of deposits (demand and time) in commercial banks, the elimination of the 5-percent reserve requirement against time deposits would release around $3.5 billion of reserves. The Federal Reserve would then have to sell this amount of Government securities in order to achieve a constant total of deposits, other things the same. Commercial banks could then add around $3.5 billion of earning assets, while losing the same amount in reserves.

Assuming that the Federal Reserve maintains the same total of deposits (demand and time), and that after the reserve requirement on time deposits

is removed there is a shift of 20 percent of demand deposits to time deposits, there would be a transfer altogether of about $6 billion of earning assets from the Federal Reserve to member banks.

Question 3. Professor Gurley, with reference to your observation that the Commission's recommendations go in opposite directions at once, let me make this observation and then ask your comment. If all of the nonmember commercial banks were brought into the Federal Reserve System, this would be giving the System control over $22 billion of demand deposits over which it now has no control. On the other hand, if we followed the Commission's recommendation and removed the reserve requirements against time and savings deposits of the banks presently members of the System, the System would lose control of over $108 billion of deposits. Do you have any comment on that?

Answer 3. I agree with you that these recommendations are inconsistent. Actually, however, by eliminating the reserve requirement on time deposits, the System would lose control of about $65 billion of deposits rather than $108 billion.

Question 4. There is one other point which you have not touched on and that is a recommendation for making reserves against demand deposits uniform for all classes of banks. I was much interested in your observation that for monetary control purposes we are as much interested in velocity as in the absolute money supply. My Federal Reserve Bulletin reports that for 1960 demand deposits in the New York City banks turned over 60 times, but the turnover in 6 other leading cities was only 34.8 times, and at 337 other reporting centers the turnover was 25.7 times.

And, of course, at the country banks the turnover is even lower, relatively speaking.

Furthermore, if I remember the historical series correctly, the differences in the turnover rate between the New York banks and other banks has been greater over the years, not getting more narrow.

Would the Federal Reserve have more effective or less effective control if the differences between reserve requirements of the various classes of banks were eliminated?

Answer 4. Aside from the velocity question, if the reserve requirements were made uniform by bringing the higher ones down to the lower ones, I believe that the Federal Reserve would have less control over money and credit, simply because some effectiveness is lost at lower reserve ratios. With regard to the velocity problem you pose, I do not think that it makes any substantial difference to the effectiveness of monetary policy whether reserve requirements are lowered at banks with high-velocity deposits or at banks with low-velocity deposits. What is important is the variability of velocity at either place, and not so much the steady differences in this respect among the various classes of banks.

Chairman PATMAN. I am sorry Mr. Curtis had to leave, but I will call his attention to the fact that he is advocating passing on the interest income through an investment trust to the beneficiary.

It occurs to me that that is very similar to the savings and loan. You see, the savings and loan is an entity to itself. The investment trust is an entity. If the earnings of a savings and loan go through the savings and loan, bypassing that entity without taxes, and the tax is on the individual who receives it, that is the same as the investment trust, another entity, making the earnings, passing the earnings on without tax to the individual who pays tax, if it is taxable.

Does that appear to you as being a correct comparison, Mr. Miller?

Mr. MILLER. I would rather not comment because I am a little confused as to Mr. Curtis' statement.

Chairman PATMAN. I will not discuss it further since he had to leave, but I will talk to him about that because it is an important point.

Senator Douglas, if you will preside, it would be appreciated very much, sir, and close up the meeting.

Senator DOUGLAS. I have only one question that I would like to put, and that is addressed to your statement, Mr. Miller.

It is on the disclosure features for pension funds. You recommend these features for all pension funds?

Mr. MILLER. This is a general recommendation.

Senator DOUGLAS. It is not merely the trade union pension funds, but for all pension funds?

Mr. MILLER. All pension funds.

Senator DOUGLAS. Whether managed by banks?

Mr. MILLER. That is correct.

Senator DOUGLAS. I want to congratulate you on that. I drafted the original bill providing for this, and in the form that it passed the Senate it had this provision in, and it was eviscerated in the House.

They are trying to improve it now. One feature of the plan was that it not only required reporting to a central authority, but also disclosure to beneficiaries, and I notice that you provide for this disclosure of beneficiaries.

Mr. MILLER. That is correct.

Senator DOUGLAS. And the second feature—this was eliminated in the House—the second feature which we provided for was that the Government agency, which received the disclosure provisions, could bring suit against malfeasors on behalf of the bank.

This was eliminated in the House, and I notice that you recommend it. This is a very constructive suggestion. We are trying to revert to the old Senate provision now. Hearings have been held in both House and Senate.

There is a tremendous amount of opposition to these proposals, and I hope that members of the Commission will use their great prestige, both public and private, to get these principles adopted into law.

Do any of you wish to make any comments on this recommendation in the final sentence of the first paragraph of page 13?

Mr. GURLEY. I am in wholehearted agreement, Senator Douglas, with it, and with your remarks on it.

Mr. Miller. I have no further comment.

Senator DOUGLAS. Thank you very much, gentlemen, for coming.

(Whereupon, at 12:20 p.m., the hearing was adjourned, to reconvene at 2 p.m., of the same day.)

AFTERNOON SESSION

Chairman PATMAN (presiding). The committee will please come to order.

This afternoon the committee continues hearings on the report of the Commission on Money and Credit. The topic of the hearing this afternoon is Federal credit programs.

We have with us Mr. David Rockefeller, who will present the Commission's views and recommendations on the subject.

Then we will hear from two distinguished academic experts Professor Johnson of the University of Chicago, and Prof. Ernest M. Fisher of Columbia University.

Mr. Rockefeller, we are glad to have you with us and you may proceed, sir, in your own way.

STATEMENT OF DAVID ROCKEFELLER, MEMBER OF THE COMMISSION ON MONEY AND CREDIT, AND PRESIDENT, CHASE MANHATTAN BANK, NEW YORK, N.Y.

Mr. ROCKEFELLER. Thank you, Mr. Chairman.

My task, as you have already indicated, is to review the recommendations of the Commission on Money and Credit with respect to Federal credit programs. This is a complex and thorny area, and no man, including those serving on the Commission—and I include most particularly myself—can claim to be an expert in all its details. The individual programs touch many areas of our economic life—housing, small business, local public works, international trade, agriculture, and transportation, to name some. All are designed to affect in one way or another the allocation of credit, and by that means the composition of total output. But the diversity of techniques used, including direct loans, Government guarantees, or insurance, and self-financed independent agencies, almost defies generalization.

Yet, it is clear that, in the aggregate, these programs now influence a very considerable portion of all flows of credit through the economy. Some $20 billion or more of direct and guaranteed loans are extended each year. By mid-1960, direct Government loans outstanding totaled $23 billion, over four times the figure at the end of World War II. Government insured or guaranteed loans amounted to another $67 billion—about 12 percent of total private debt outstanding.

This enormous growth has not always been orderly, or its full implications foreseen. Thus, it was clear to the Commission that the proper relationships of these programs to the rest of our financial system and, in particular, to the whole fabric of Government economic and stabilization policies needed examination and definition, however difficult the task.

SCOPE OF THE COMMISSION'S STUDY

I would like to emphasize as strongly as I can at the start that the Commission did not conceive its function as one of appraising the desirability of the broad social objectives of existing Government programs. Moreover, we did not recommend new programs to meet new objectives.

Decisions of this kind are essentially political. As such, they are properly the responsibility of the Congress. Individually, many of us had strong personal views on these matters. Some felt that certain Government programs already went too far in subsidizing one group or another, while others felt that a number of new programs of this sort should be undertaken. However, these questions of social philosophy, in our collective judgment, lay outside the scope of a report on ways to improve the performance of the whole financial mechanism.

Instead, we tried to spell out certain broad criteria or guidelines that could be applied to Federal credit programs generally. These guides concern preferred methods for reaching given objectives and the use of credit programs as a part of general Government stabilization policies. They should be useful in appraising the performance of Federal credit programs whatever their particular objectives.

By way of illustration, we also pointed out some specific ways in which existing programs might be changed or supplemented to accord with our general guides. But, within the limits of time available, more detailed recommendations of this sort were confined to a few programs with a wide influence on major sectors of the economy and the credit markets.

THE BASIC PHILOSOPHY

In developing its recommendations, I think that it would be fair to say that the Commission was agreed that, in this country, responsibility for the allocation of credit would and should remain primarily a function of competitive private market systems. This, of course, does not mean that we were satisfied that the private markets are operating with full effectiveness in every respect today; you heard Mr. Miller outline this morning some Commission recommendations designed to stimulate enterprise and competition in those markets. Moreover, we recognized that, under some circumstances, Federal credit programs may themselves have a legitimate role to play in improving the effectiveness of private markets.

TRUE CREDIT GAPS

This would be true in the case of what the Commission termed a "true credit gap." These gaps may arise from institutional factors, such as legal barriers to the free flow of mortgage credit over State lines or adherence to traditional lending policies when basic circumstances have changed. Absence of knowledge on the part of borrowers or lenders, imperfections in competition, or inability of private lenders to spread risks over a sufficiently large group can also impede the flow of credit to points of greatest demand. When the result is to reduce the supply of credit to some potential borrowers, while others—basically no more credit worthy—can obtain funds more freely at lower rates, a true credit gap exists.

Certain regulatory policies of the Government itself may contribute to these gaps. In those instances, the solution may be found in changing those policies. But certain types of Federal credit programs have also proved a useful device.

SELF-SUPPORTING PROGRAMS

In designing credit programs to close these gaps, the Commission urged that they be made self-supporting to the extent they possibly could be. What is needed in situations of this sort is a device to stimulate competition and enterprise—not subsidies to special groups.

An insurance-type program on the FHA model meets this criterion. The borrower, in return for a Government guarantee, pays a fee sufficient to cover both administrative costs and losses from defaults. Since the Government may be in a unique position for both assessing and spreading risks and enforcing uniform standards, no private institution may be able to perform quite the same function. But funds for the loan are provided by private lenders in the open market. The result is a relatively standardized, widely acceptable credit instrument subject to regional and national, as well as local, competition.

A federally sponsored lending agency—following the pattern of the Federal land banks—is a possible alternative to the proposal I have outlined. Agencies of this sort borrow in their own name in the national credit market to obtain funds for relending to private borrowers at a rate sufficient to cover costs. As initial Government capital is retired, they may become fully self-supporting.

The Commission, however, prefers the insurance method whenever feasible. Federally sponsored agencies compete with private institutions without necessarily stimulating competition among them. At least initially, an element of subsidy is involved, and, as a practical matter, these agencies have been generally slow and halting in development.

Consistent with this approach, the Commission recommended that the FHA loan insurance program be continued to facilitate the flow of credit into residential construction. It also proposed—with some reservations—new programs functioning along similar lines for farm operators. The purpose would be to assist able farmers to acquire the sizable amounts of land and equipment necessary for an efficient farming unit today. However, such a program, enacted today, would entail a heavy risk of aggravating the problem of farm surpluses and could contribute to further increases in prices of farmland. The Commission warned that the proposal should be weighed in that light.

SUBSIDIZED PROGRAMS

Closing a true credit gap is not the only purpose of Federal credit programs. In some instances, Congress has wished to promote certain objectives—national defense, widespread homeownership, rural electrification, or others—by providing to one sector of the economy more credit than it could obtain in even a perfectly functioning free market. This necessarily requires a subsidy.

The subsidy can be provided by a Government guarantee, cost free to the borrower. VA loans are one current example of such a guarantee program. Just as in the case of an insurance-type program, funds for a guaranteed loan must be obtained from private lenders at market rates, but the borrower benefits from the higher credit standing of the Government without bearing any of the costs of defaults or administration. Alternatively, a subsidy can be provided by a direct Government lending program. Then, the Government itself will provide the loan funds at whatever rates it deems appropriate.

The choice between a direct lending program and a guarantee program, in the opinion of the Commission, should be based on the principle of least cost and least interference with the private financial system consistent with the objective sought. In most cases, this means a guarantee program is preferable. Like insurance programs, these operate through private institutions rather than in competition with them. And experience shows that establishing a new direct lending agency can be a time consuming process.

However, the amount of subsidy that can be provided by a guarantee program is limited to the value of that guarantee. In cases where a greater subsidy is required to meet the objective, there can be no alternative to a direct lending program, in which the government has full control over rates and terms.

In such a program, it is important to set eligiblity standards in such a way as to exclude those borrowers who could obtain the same funds elsewhere. This is not always easy, and it becomes particularly difficult in instances where the complexity of the program or the form of the subsidy discourages rational consideration of its merits. Thus, the "Fannie Mae" special assistance program has, to all practical purposes, become a direct lending program, since it holds the bulk of the mortgages it has purchased at prices above those prevailing in the market. However, it is extremely difficult to measure the amount of the subsidy involved, and to weigh benefits against costs. Similarly, it would, in the judgment of the Commission, be desirable to make the implicit subsidy resulting from the extension of credit at 2 percent to rural electric cooperatives a specific charge in the budget.

RELATIONSHIPS TO COUNTERCYCLICAL POLICIES

The Commission does not believe that the amount of credit extended through direct lending programs should necesarily be varied over the course of a business cycle as it recognized that, in some cases, changes in a program to counter swings in business activity would sharply reduce its long-run effectiveness in terms of its own program objectives. On the other hand, these programs should not, merely by virtue of being a Government program, necessarily be insulated from variation over the cycle. In fact, variations in certain programs, such as those of the Community Facilities Administration or urban renewal, may be a useful adjunct to general stabilization policies over the course of longer business cycles.

While certain direct lending programs can sometimes be used flexibly to reinforce countercyclical policies, there are great dangers in any attempt to support very broad segments of the total credit market by use of Federal credit programs. Thus, purchases of mortgages above market prices by the Federal National Mortgage Association have sometimes had the intention of reinforcing the impact of easy money policies on the mortgage market, or of insulating that market from the impact of restrictive policies. The inevitable result is either massive purchases, in an attempt to make the lower rates effective throughout the market, or indiscriminate rationing and windfall profits to particular groups. Both consequences were apparent in 1950 and again in 1958 and 1959, when "Fannie Mae" purchased mortgages in large volume, but not without limit, at a time of rising economic activity.

INTEREST RATE CEILINGS

Other difficulties arise when rigid interest rate ceilings are employed in credit programs that rely upon private institutions to provide funds. It is fundamental to the success of the FHA and VA mortgage programs, for instance, that they provide an investment opportunity to potential lenders as attractive as available alternative outlets for their money. Thus, if these programs are to be effective, without becoming what would amount to a direct lending program, their interest rates must be varied in line with general market forces.

Rigid statutory or administrative interest rate ceilings usually are intended to protect the borrower. But their real effect, when the ceilings are out of line, is to deny the otherwise eligible borrower

access to funds and to encourage subterfuges and hidden costs. As a result, these ceilings frustrate the very competitive forces and market mechanisms that the Commission would like to see strengthened.

It is clear that unrealistic ceiling rates for FHA and VA mortgages in the past have sharply curtailed residential lending Government programs during past periods of rising market interest rates. The result has been to exaggerate the instability of that portion of the economy. It has been argued that this is desirable, since the declines in home building roughly coincided with upswings in other areas of the economy. But, in the judgment of the Commission, these exaggerated swings in home building resulting from interest rate ceilings—with their precise timing capricious and unpredictable—are on balance undesirable.

Credit programs relying on the private market for funds should be sensitive to general monetary policy, but they should not bear the brunt of the impact, as the FHA and VA program has at certain times in the past. A preferable method for reinforcing the impact of monetary policy, if this seems desirable, would be discretionary changes in downpayment and maturity requirements for FHA mortgages.

SECONDARY MARKET PROGRAMS

It is implicit in the whole Commission approach that Federal agencies designed to create or maintain secondary markets for credit instruments should not attempt to control their prices. The Commission recognized the need for a better secondary market in mortgages, and it hopes private institutions will develop to fill that gap. In the meantime, a program along the lines of the FNMA secondary market operations should be continued. But, it is our feeling that this dealer function would be more effective if it could be separated, clearly and unambiguously, from other FNMA functions. Preferably, this function should be placed in a separate agency.

In closing, I should point out what is obvious to a reader of the report and its footnotes. A few Commissioners felt that we should have been bolder in seeking out and identifying areas of the economy in which new credit programs might be useful in the future. And, as might be expected, there was not unanimous agreement on the specifics of all our proposals. We all recognized that our guidelines will not always be easy to apply in practice. This is too complex and controversial an area for that. But we are convinced that the general guidelines set forth can be helpful in achieving more effective Federal credit programs, consistent with a strong and healthy private financial mechanism.

Chairman PATMAN. Thank you very much, Mr. Rockefeller. We appreciate your testimony and it will certainly received consideration.

As the head of what I consider to be the largest bank in the world, considering all of its operations, I feel that I just want to ask you a few very simple questions relating to the domestic economy.

I have been troubled recently about the difference in the rates of interest that people are paying in other sections of the country, and I would just like to know why the rates are higher in the South and West than they are in New York City and New York and New England.

Mr. ROCKEFELLER. You are speaking now of interest rates paid by private industry?

Chairman PATMAN. By private borrowers, both from banks and business loans, and as mortgage loans.

Mr. ROCKEFELLER. Of course, the prime rate charged by banks, I think, is fairly standardized throughout the country. The individual rates that are charged by individual banks in different parts of the country would be determined by a variety of factors:

In part, by the available supply of money and credit to individual banks; and, on the other hand, by the risks involved in the particular loans in question.

In other words, we, ourselves, charge different rates to different customers, based on the security and risks involved, and this would obviously be a factor in answering your question, Mr. Chairman.

Chairman PATMAN. It was mentioned here by some witness the other day that the prime rate, when it is changed, is always initiated in New York. Is that your understanding?

Mr. ROCKEFELLER. No. I think New York is still the principal money market center of the country, and New York banks have more frequently been the leader in initiating changes in the prime rate than other parts of the country. But, as a matter of fact, there have been instances where banks in other parts of the country have taken the initiative.

Chairman PATMAN. I will ask you if this is your understanding, if it is generally correct. Is it not true that banks in the South and West have more funds on deposit with banks outside these regions than they have on deposit and on loan from banks outside of these regions?

Mr. ROCKEFELLER. Mr. Chairman, I do not have at my fingertips the answer to that question. I am a little surprised frankly by it.

Chairman PATMAN. That is all right.

I will get that information anyway from someone who keeps up more in detail with it than you would be expected to.

I ran across a new phrase here today that is used, I understand, in banking circles that I did not know much about. That is "after-the-fact financing." What does that mean?

Mr. ROCKEFELLER. In what connection did this occur?

Chairman PATMAN. I ran into it this way. A person who is financing a loan of about $10 million for a project, and he was signing up the papers at that time, he said, to take care of after-the-fact financing.

It required the keeping on deposit of about 20 percent or $2 million to make sure and guarantee that everything would be taken care of after the accomplishment of the contract.

Mr. ROCKEFELLER. So far as the deposit aspect is concerned, Mr. Chairman, as you know, one of the problems that all commercial banks in this country face is how they can get sufficient deposits to handle their customers' needs for loans, so that it is customary for most banks around the country to insist upon an appropriate deposit relationship in relation to credit lines, and to outstanding credits. 20 percent is a figure that is sometime heard in that connection, although there is no absolute or firm understanding.

Chairman PATMAN. I am acquainted with that where the bank makes a loan and feels you should keep a certain percent on deposit, and 20 percent, it is my understanding, is a customary percentage. But this goes beyond that.

This is after the contract has been accomplished, has been achieved, and the deposit is to remain there for what they call after the fact.

Mr. ROCKEFELLER. I am bound to say, Mr. Chairman, that this is not a term with which I am familiar or which we use currently in our bank.

Chairman PATMAN. That is sufficient then. I just did not know about it. I had never heard of it. This gentleman told me about it.

Mr. ROCKEFELLER. It is not an expression that I recall our having used.

Chairman PATMAN. It is not a customary expression, at least?

Mr. ROCKEFELLER. No.

Chairman PATMAN. Senator Javits, would you like to ask any questions?

Senator JAVITS. Yes, I would.

Mr. Rockefeller, first, let me welcome you here as your Senator and express my pleasure at the very important role that you have taken in the drafting of this critically important and, I think, historic report.

I would like to ask you a few questions about a matter which is not covered in your statement, but in which I think you can give us some very important help, and that is the chapter of the report which we did not call for discussion upon, the international monetary relation.

And I understand you headed that task force, is that correct?

Mr. ROCKEFELLER. That is correct.

Senator JAVITS. I might explain for the benefit of your own understanding our failure to ask for that as a matter within the compass of the Subcommittee on International Exchange and Payments, headed by Representative Reuss, of which I happen to be a member, and indeed, immediately after this meeting we are meeting to finalize our report.

So perhaps you can be of help to us in any reflections that you might have on that subject.

Now, there are three things which are of vital importance in that regard.

(1) Whatever program we feel should be recommended for dealing with our imbalance in international payments.

Of course, you dealt with that at considerable length, and pointed out at page 14 of the Commission's report how we had managed to liquidate an extremely large deficit in our balance of payments, which has continued now for a whole decade, and indicating what I think most people so often forget: That we have been helped in the financing of this deficit by other industrial nations through the acquisitions of liquid dollar assets by their central banks to a very large sum, almost $9 billion.

(2) The other thing that I think interests us tremendously is what has happened to the U.S. competitive position in the world, both with respect to exports as well as imports, but, more importantly, with respect to exports in terms of our foreign markets.

(3) Finally, I think the other thing that interests us greatly is what should be our trade policy as it relates or as it is conditioned by money and credit. What should be our trade policy, because next year we are coming up to the reciprocal trade agreements renewal.

There is a great stirring in the country, which some of us think indicates a much stronger protectionist position than heretofore, and we may be in for some very rough times on trade. As the favorable trade balance has been the only real barrier to a disastrous drain of our resources in terms of an imbalance in our international payments, which would be $6 billion more in some years than it actually was were it not for so favorable a balance in trade, this becomes a matter of prime interest.

So would you in your own way give us some point of view on this international monetary situation?

Mr. ROCKEFELLER. I would be very glad to, Senator.

Perhaps I should refresh the memory of the Senator and the committee that I did testify earlier in the summer on this very subject, and I believe that my testimony is available before the subcommittee to which you referred.

Senator JAVITS. I might say that we availed ourselves of it in the report. But in view of the fact that we are making a record on the Commission's report, I think it might be useful if we had something on that.

Mr. ROCKEFELLER. I would be very pleased to.

I should further comment that I had not expected to testify on this today. I have been in Europe for the past 5 weeks, and, therefore, my memory on specific recommendations of the report in this regard may be a little bit fuzzy.

Senator JAVITS. May I make a suggestion with the permission of the Chair. We have a rollcall vote right now which will take us away for a few minutes.

Would you prefer, Mr. Rockefeller, to update as a statement your testimony before the subcommittee, and then include that statement in reply to my questions as part of this record?

Mr. ROCKEFELLER. You are very kind, Senator. You mean at a later time?

Senator JAVITS. Yes.

Mr. ROCKEFELLER. And send it in, in writing?

Senator JAVITS. Yes.

Mr. ROCKEFELLER. If this would be preferable, I would be very glad to do that.

(Mr. Rockefeller's statement will be found in the appendix at p. 484.)

Mr. ROCKEFELLER. Or I can comment briefly and off the cuff now, just as you prefer.

Senator JAVITS. Why do you not do both? Would you do that? Tell us whatever you have in mind.

Chairman PATMAN. We will ask Mr. Rockefeller to remain until you get back, if that is all right.

Senator JAVITS. Fine.

Chairman PATMAN. And it will not be long, and we will ask you a few questions.

Senator JAVITS. Thank you very much.

Chairman PATMAN. Senator Proxmire wanted to ask you a few questions, too.

Mrs. Griffiths?

Representative GRIFFITHS. I do not have any questions right now. I am sorry to have missed your testimony.

Chairman PATMAN. Mr. Rockefeller, in the light of your definition of a "true credit gap," which you gave in your testimony, do you feel that small business now has an adequate source of credit?

Mr. ROCKEFELLER. This was a matter that was of very great interest to all the members of the Commission, and we sponsored a number of studies on that subject to try to get an accurate answer.

We found that the statistical information available on it is very limited and difficult to appraise. We found that there was no clear-cut proof that small business has or has not adequate credit available.

One thing we did find is that the ratio of small business to large business countrywide has not diminished; in fact, small business has increased rapidly over recent years, which would seem to suggest that small business credit was not altogether lacking. It was our feeling that, in the absence of fuller information on this subject, that it would seem desirable to continue the efforts of the Small Business Administration in working with and helping small business.

But we did not find any evidence that would indicate that there is any great credit gap in that field.

Chairman PATMAN. I find that a number of the banks over the country will not cooperate with the Small Business Administration. Is that generally true in the New York area?

Mr. ROCKEFELLER. I was not aware of any lack of cooperation.

Chairman PATMAN. I am sure it does not prevail there. But in some sections of the country they just do not want to cooperate with the Small Business Administration.

Mr. ROCKEFELLER. Certainly in our own case, we are very much interested in small business. We have, as you perhaps know, 104 branches around the city, and their prime livelihood comes from working with and assisting small business. We are very proud of some of the small businesses that we have helped to finance in the early days that have since grown into quite big businesses.

Chairman PATMAN. Of course, that is the ambition of every small man, to be a big man.

I would like to have your opinion about the desirability of a branch banking system in our country. The way I view this report, it is headed in that direction; that is, to have branch banks in metropolitan areas, notwithstanding State lines or county lines.

In other words, if the metropolitan area of Chicago goes over into the State of Indiana or Michigan, it is all right, to have branch banks regardless of State lines or county lines.

In that way, we would soon only have a few branch bank systems, the way I view it.

How do you view it? They would have the business of the country.

Mr. ROCKEFELLER. As you rightly recall, Mr. Chairman, the Commission felt that the unit banking system, if it were carried to the extreme and there were only unit banks, would not provide for adequate competition, and that the credit facilities of the unit banks would be insufficient in the country. Therefore, it felt that there

should be an expansion rather than a contraction of the branch banking system.

As you rightly recall, also, the recommendation was that it would be logical to have branch banking within trade areas. That was the term that was used.

And it is perfectly true that trade areas do not always correspond with State lines. For example, in the New York area, the trade area would relate much more across the river to Newark and even up along the coast to Stamford and some of the Connecticut communities than it would, for example, to Buffalo. The Commission felt that it would be in the interest of those communities if branch banks, if a branch banking system could extend within the trade area.

Now, you have, admittedly, touched upon a problem that was very much discussed, and I am not sure that all of the angles of it were adequately considered.

Admittedly, if you did have a branch system which crossed State lines, it is hard to see what would come of the State supervision and of the State banking system in those areas. As one who is an officer of a State bank, this perplexes me. I think that there has been real merit to the dual banking system—I am now speaking for myself—and, therefore, I am puzzled by how one could maintain the State banking system in a vigorous way and still have a regional banking system that would cross State lines.

This, frankly, I think, is going to need more thought, and I hope that more thought will be given that problem by the Congress.

Chairman PATMAN. The arguments—I should not say "arguments," there is no argument about it—the statement that you made about the value of the branch banking system, what can you say for such a system that is better than an adequate and efficient correspondent bank system? In other words, where would the branch bank system be better than a good correspondent bank system?

Mr. ROCKEFELLER. I think in two respects that I think of right off.

In one instance, on the competitive angle, I think this is quite an important angle, I think that you are more apt to get less competition, in small communities where there may be one vigorous unit bank than you are in a system where there is the possibility of branching and where you are apt to get two branches of a larger branch system.

I think that the unit bank in a small community, where it is the only bank, is more apt to be able to keep out competition than is the branch bank, so that I think in terms of competition the branch system has something to offer that perhaps the correspondent banking system does not always offer.

The other side is in connection with specialized services. By and large, the larger banks which have a branch system can afford many sorts of specialized service in the international field, in the trust field, and in others, which unit banks which have not the opportunity to branch out could not afford, and which would be less readily available through the correspondent system than it would through a branch system.

Chairman PATMAN. According to what you have just said, then, if a branch bank comes into town A, where there is a local bank, that local bank probably would not survive long, because the branch bank would offer services that the local bank could not offer.

Mr. ROCKEFELLER. I did not mean to imply that, sir, and I do not believe that this would necessarily be true, nor do I think that history would substantiate that. There are many instances around the country and in our own neighborhood where there are vigorous independent banks, and also branches of larger commercial banks.

There are many appeals to the individual unit bank on the part of the community. There are many people who like the idea of a local bank, and those people would normally go to the unit bank.

So that I do not feel that that follows, and I do not think, in fact, it has happened.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. On page 196 of the Report—and I understand that your appearance is in connection with that chapter, which is chapter 7, on the Federal credit programs, is that right, sir?

Mr. ROCKEFELLER. Right, Senator.

Senator PROXMIRE. You discuss the small business program, and you say:

> The share of small business in all business has not declined.

Do you have any statistical support for that position?

Mr. ROCKEFELLER. We were just discussing that when you were out, Senator. I was saying that the information about the availability of credit to the small business is rather inadequate and sketchy, but I think, so far as this particular statement is concerned, that the Department of Commerce and other figures do substantiate that.

I do not recall—possibly Mr. Fox, who is here, if you want to get the facts, could tell us——

Senator PROXMIRE. I want to get all the documentation on that, that I can. I am chairman of the Small Business Subcommittee of the Banking Committee of the Senate, and all the evidence we have has indicated that small business has declined in many, many areas.

Of course, we are most conscious of its great decline in the area of defense procurement where it has dropped from 25 percent down to what—15 percent?

But, in general, the sales of small business and the opportunities for small business seem to have dried up somewhat. I would be very interested in any statistical evidence.

However, that does not go to the main thrust of your presentation here. I am interested in it, also, because of bills that are now pending—we are about to mark them up next week—on both the SBA's authorization and also on the SBIC's new request authorization.

You say the SBIC program appears to be promising. What is that based on?

Mr. ROCKEFELLER. It has only been in existence a short time. However, I think that there is evidence that in several parts of the country there is perhaps growing interest in organizing the SBIC's, and I think it was based on that statement that was made.

Senator PROXMIRE. The Congress is in a delemma on this and maybe you can help us with it.

The dilemma is how to provide additional long-term funds for small business, and to do it as quickly and as readily as possible through private institutions.

Most of us want to get the Government out of this as fast as we can.

At the same time the bill we have before us would increase the authorization by some $150 million, as I recall, and would provide substantially more Government money to SBIC, go up to $1 million instead of $150,000, and I am wondering if on the basis of the inquiry that you conducted here, if you feel that the SBIC program might be viable on the basis of the provisions now in the law which do permit some tax advantage and some other advantages which would attempt to bring about the result of SBIC going to private institutions almost entirely with as little Government funds as possible.

Mr. ROCKEFELLER. The Commission would certainly favor that approach rather than a direct loan approach. I think its feeling was, as I said before, that the program has been underway for so short a time that it is really too soon to know whether the present approach is going to be successful and adequate, or whether there are alternative methods that would be preferable.

Our feeling was that we should, by all means, proceed with the present program and give it a fair chance, and hope that it would prove to be adequate.

We had no reason to feel that it was not.

As I said earlier, we really had no reason to feel, from the evidence that we had, that there is, in fact, a credit gap for small business. The statistical information that we were able to obtain did not demonstrate that, and I must say that our experience in our own bank has not indicated that there are small businesses with adequate management and capital—in other words, who had a proper claim on credit—who were not able to get it.

Our experience has been that the problem is more in the field of inadequacy of equity capital and insufficiency of good management rather than short or medium term credit.

Senator PROXMIRE. Short or medium term credit, I would agree. But this SBIC was the outgrowth of some 25 studies that had been made by industry groups, Government groups, and so forth, over many many years, which all seemed to indicate there was inadequate long-term equity capital.

Its purpose is to provide that long-term capital either in equity or very long-term loans.

It was with that in mind that we thought we could fill in this gap, but, as I say, we want to do it as much as possible through private institutional operation.

The next proposal is quite a radical and surprising recommendation, it seems to me, that does not get very much attention, but there is only one footnote disagreeing and that is from Mr. Fred Lazarus, Jr., and that is a loan insurance program available to all lenders, all lenders, and you suggest it might be pretty extensive insurance, saying that 10 percent obviously would not do much good, 100 percent would be too much, there would be no risk, and, therefore, there would be a lot of bad loans made, but that something in between, 50 or 60 percent, possibly, would be a consideration.

I am surprised—I think it is a very interesting suggestion—that that kind of quite drastic proposal does not have more attention here.

Mr. ROCKEFELLER. As I explained while you were away, I have been out of the country for several weeks. To be perfectly honest with you,

I do not recall in detail the discussion on this point, and, therefore, I would be a little reluctant to report to you the Commission's conclusions on it.

Senator PROXMIRE. Then on page 204 of the report, the recommendation:

> The Commission recommends that the FHA- and VA-underwriting programs be used to aid in implementing countercyclical price-stabilizing policies of the Government by variation in the terms of the underwritten lines and by allowing contractual interest rates to rise and fall with conditions in the mortgage market.

Is this simply another way of saying that you would knock out rate ceilings and that you feel that this would be a stabilizing influence, if you did so?

Mr. ROCKEFELLER. We certainly feel that rigid rate ceilings in any are are undesirable. Would you tell me again the page?

Senator PROXMIRE. This is on page 204 of the report. It is in this chapter that you are discussing today. The first bold-faced recommendation there on FHA and VA.

Mr. ROCKEFELLER. Yes.

Our feeling on price ceilings, as you have probably noticed throughout in the report, was that this was a mistaken approach; that it was undesirable in terms of the overall economic objectives of the country; that it tended to interfere with the free working of the price mechanism.

Senator PROXMIRE. You feel, then, for example, if the "Fed" is following the policy of contraction to increase interest rates and to discourage inflationary forces on the one hand; but FHA and VA, because of statutory requirements, keep their interest rates down, on the other that it tends to defeat that policy?

Mr. ROCKEFELLER. We do feel that it does tend to defeat it, particularly if the mortgage market is requested to make the ceiling rates effective, and that on the whole it is disadvantageous.

Senator PROXMIRE. Of course, the difficulty, you have a very broad-gage Commission. But it is at least somewhat high interest. I realize these are not entirely financiers with financier viewpoints.

There is a lot of suspicion in the Senate, and I know there is in the House on the financial viewpoint. Congressman Patman has been a very distinguished and eloquent champion of the view that interest rates have been too high, and I have done the best I can in my much smaller way in the Senate.

Our feeling is that this is not exactly a Wall Street viewpoint but a viewpoint of people who are lenders, who do benefit from high interest rates, whose interests clash with those of the great majority of people who are borrowers rather than lenders, and, therefore, we feel that the limited opportunities that Congress has to restrain interest rates would seem to be in programs of this kind.

That if we let that go, then we have no opportunity to protect the borrowers of the country, because the Federal Reserve Board seems to be somewhat oriented toward the same financier viewpoint, a very legitimate and proper viewpoint that should be represented, but it seems in the position of decision in America that it has all the power.

Mr. ROCKEFELLER. I think the Commission would disagree with you that this represents what you have described as the financier viewpoint.

The Commission's feeling is that it is impossible, unless you want a

completely controlled economy, to hold certain prices, whether they be interest rates or other types of prices, Senator, and not cause imbalance in the economy.

The whole basis of our economy is that there should be a free play of market forces through the price mechanism, and the interest rate structure is one part of that price mechanism, and a very important one.

It is our conviction that the borrower is not, in fact, protected by having a price ceiling, because the fact is that if the interest rate in the particular type of credit is held at a certain level, unless the Government steps in and provides credit on a subsidized basis, it simply means that there would be less credit available in that field, or it will encourage all kinds of subterfuges and ways of getting around the interest rate as a means of getting a higher return.

Our feeling is that it is far preferable and definitely in the interests of the borrower and the consumer that interest rates be allowed to fluctuate as the market dictates.

Now, if it is determined by the Congress or the administration that it is desirable to ease credit for whatever purpose, there are other ways of accomplishing that, short of imposing interest rate ceilings.

Senator PROXMIRE. But you would not quarrel with the decision of the Congress, if it decides to do so, to provide more money for "Fanny Mae," to provide direct loan funds, if the Congress feels that the best way to work economic justice—for example, with farmers, if we determine that the REA loan rate of 2 percent, which you criticize as a subsidy, is at a cost to the taxpayers, but is desirable and necessary because of other inequities that the farmers have and because of the great desire to encourage improvement of efficiency in farming, you would not argue with the right of Congress to go ahead and do it?

Mr. ROCKEFELLER. Certainly not.

Senator PROXMIRE. But you would say, if we do it, we should do it with our eyes open?

Mr. ROCKEFELLER. And face it squarely and call it what it is and make it a subsidy.

Now, obviously, Congress cannot subsidize everybody, and, therefore, it seems to me that it is important that it should be made clear to everybody in Congress and in the country as to what is being subsidized and why.

And I think that interest rate ceilings tend to conceal in some cases subsidy, and to distort the price mechanism.

Senator PROXMIRE. Then I wanted to ask you, also—I did not have a chance to ask Mr. Wilde, but you are in an excellent position to comment on it—are the directors of your grant bank bankers or are they people from industry, generally?

What is their background?

Mr. ROCKEFELLER. By law, they could not be bankers, either commercial or investment bankers. They represent a broad range of prominent citizens who are in different industries and who represent our customers and our customers' interests.

Senator PROXMIRE. The reason I am asking this question is, I wanted your observations on the Commission's recommendation that the Federal Reserve Board Governors be men of more specific experience related to the job they have to do, and that we perhaps overlook the geographical requirements or repeal the geographical requirements.

Mr. ROCKEFELLER. Yes.

Senator PROXMIRE. What do you think of that law? How has it worked out? Have the Chase Manhattan directors been useful? Do you think they could be improved, if you did not have this requirement, if you could tap people from the same community, with the same financial background, I should say?

Mr. ROCKEFELLER. I would not see any particular merit to that. I think perhaps the analogy between the Reserve Board Governors and bank directors is not too good. I think, in the first place, the Reserve Board Governors are full-time employees in much the sense that officers of the bank would be, and, therefore, it seems to me of the utmost importance that they, as, in effect, officers, have some knowledge in this field of finance.

We look to our directors not so much to guide us in terms of making loans and specific, detailed considerations, as overall, broad policy matters.

Senator PROXMIRE. I understand my time is up.

Chairman PATMAN. Senator Pell?

Senator PELL. I would just like to express my pleasure and indicate the interest these hearings hold for the whole banking community by pointing out that the president of one of my own finest banks at home, Mr. Scola of the Columbus National Bank, is here listening, and I would like to welcome him to these hearings.

I have one question, Mr. Rockefeller, and that is: What are the competitive differences between the interest rates in New York from bank to bank with the risk being the same? Would you say it is a half percent, a whole percent?

It is a question that I have often asked myself.

Mr. ROCKEFELLER. I do not know that I could give a general answer to that question. This really comes down to the judgment of the individual lending officer as to what the risks involved are.

If, of course, the company is considered to be a prime credit risk, and if the loan is a normal one, then the prime rate would be apt to obtain.

On the other hand, if the risks, for whatever reason, are greater, then the rate would be increased, and this is a matter of individual judgment.

I really do not think that there is any way that I could answer your question in a very meaningful way.

Senator PELL. And, along the same line of interest rates, as I understand it, our own interest rates in the United States are a lot less than they are in any other capitalistic nation; is that not correct?

Mr. ROCKEFELLER. This varies depending on money market conditions. There have been times when they have been higher than they have been in England, for example, or Germany. I think probably on the whole rates in their country are lower.

Switzerland would be an instance, for example, where rates have been lower than in the United States a good many times, because money has frequently been very plentiful there. In fact, there have been times when the Swiss banks, because they had such large deposits, so many people wanted to keep deposits there, have actually charged people for putting money on deposit because they did not have enough opportunities to loan, so that I think your observation is generally true, but not entirely true.

Senator PELL. Thank you very much.

Senator PROXMIRE. Just one more question before I run, and that relates to this line I was pursuing on the Federal Reserve Board Governors.

Is it not true that a Federal Reserve Board Governor can bring a lot to this job if he has as broad a public perspective as possible, rather than a perspective which is necessarily primarily that of a financier or a banker?

What I am thinking of is the thrust of the recommendations in the report seems to be that you should get pertinent experience, and I am afraid that you are going to get away from the broad public viewpoint, which is so important in the Federal Reserve, and I think is its greatest inadequacy, its greatest loss:

The fact that the Reserve has tended to orient toward a fairly narrow view of the technical operations of our banking system rather than as broad a responsibility to our overall economy.

Mr. ROCKEFELLER. Senator, if you got that impression from the report, I think it must mean that the report was not written clearly, because I certainly did not get the impression from the discussions that I heard on this subject that there was any desire to narrow the breadth of type of person that would be employed as Governors of the Federal Reserve.

Quite the contrary, the whole thrust of that section—in reducing the numbers, in reducing the length of the term, and in the suggestion that they be paid a maximum amount—was to get the broadest possible, best qualified people for this extremely important job.

Senator PROXMIRE. I am delighted to hear you underline "broadest."

Mr. ROCKEFELLER. Definitely.

And I think this would be the general view of the Commisisoners. Certainly, I think they would feel that they should have some knowledge of the money market and finance. I do not think they could very wisely be selected from some field which was completely strange.

On the other hand, I am sure that they would all favor the broadest possible background.

Senator PROXMIRE. Thank you very much.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much.

I would like to ask you some questions, Mr. Rockefeller. If you have $100 million to lend from a bank, and you lend $50 million of it to one prime credit risk, and the other $50 million on 2,000 loans, I believe at $25,000 each, would you allocate the expenses of operating that bank 50 percent to the $50 million credit risk and 50 percent to the other 2,000, or do you allocate one-two thousandth to the first $50 million credit and the other part of it to the 2,000 loans, or is it something in between?

Mr. ROCKEFELLER. In the first place, by law, we can only lend 10 percent of our capital and surplus to any one person, so that the situation you describe would be illegal.

Representative GRIFFITHS. Could not occur.

So I will break it down into five loans of $10 million each. Do you allocate 50 percent of the cost of operating the bank to those five?

Mr. ROCKEFELLER. The fact is we do not allocate costs to accounts. That is not the way we do it.

Of course, we sometimes make an analysis of the costs of rendering a particular service to a customer, because sometimes it is necessary to make additional charges if there are unusual and special services; then we would do that.

But, normally, we do not attempt to analyze the costs of handling all of our accounts, and we do not allocate our costs that way.

So I really do not believe I can answer your question.

Representative GRIFFITHS. I was interested in that part of it.

Now, do you determine the amount that you are going to charge in interest on the basis of the risk involved; that is, does the prime credit risk pay a lesser rate of interest than the 2,000 loans, say, on conventional mortgages would pay?

Mr. ROCKEFELLER. Prime credit risk does not relate itself necessarily——

Representative GRIFFITHS. To the interest rate?

Mr. ROCKEFELLER. Or generally to size. Prime credit risk relates itself to the size of the loan in relation to the credit worthiness of the particular company and to our judgment of its management, which is quite a different proposition.

It is quite conceivable that a loan of $1,000 to a small, well-run, very solvent company would be a far better credit risk than a $10 million loan to a large company that was in trouble.

So that I think you are perhaps mistaken in thinking that there is a relationship to the size of the loan alone.

Representative GRIFFITHS. I am not thinking it.

Mr. ROCKEFELLER. Excuse me.

Representative GRIFFITHS. I am simply asking.

Mr. ROCKEFELLER. In our judgment, they do not.

Representative GRIFFITHS. They do not.

You base it every time on individual judgment?

Mr. ROCKEFELLER. Absolutely.

Now, of course, individual judgment within a framework, because at any given moment in time the whole level of interest rates is determined by the supply and demand for funds, and if our loan ratio relative to deposits is high, then naturally our whole level of interest rates is higher than it would be if it were very low.

Representative GRIFFITHS. If a guaranteed risk comes into the market for a loan, this reduces the area in which your judgment has to operate, does it not?

Mr. ROCKEFELLER. Are you speaking of Government guarantee?

Representative GRIFFITHS. Yes.

If you had the money, you would simply lend it, is that right?

Mr. ROCKEFELLER. Obviously, this simplifies the problem of credit judgment from the point of view of the officer. If it is an unequivocal and clear Government guarantee, that puts it in a separate and different category.

Representative GRIFFITHS. I started out to ask you, under the circumstances, if you removed the ceiling rates on VA and FHA loans, would it not tend to be inflationary? You answered, I believe Senator Proxmire, that you thought this was not necessarily true, because people are already getting around the ceiling rates through devious means.

Do you think that is true?

Mr. ROCKEFELLER. I would not think it was inflationary, assuming, of course, appropriate general credit policies. I think higher rates would have the tendency to curtail investment in homes, there is no question about that.

I think, as indicated by the studies for this report, the homebuilding field tends to be more sensitive to changes in the interest rate than some other fields, so that certainly a higher interest rate would tend to curtail construction.

On the other hand a ceiling on interest rates, unless it were accompained by Government intervention to provide credit, would not necessarily increase building, because credit would not be forthcoming at an artificially low ceiling.

Representatives GRIFFITHS. This ceiling on the mortgages now does have some determination on who is going to get the money, I mean whether it is going to be put into homes, channelled into homes, or channelled into businesses, if there is a shortage of money, is that not true?

Mr. ROCKEFELLER. Certainly, if you have an artificial ceiling on one end of the economy and do not on the other, and you can get higher rates in the other areas, the tendency would be for more money to flow into those areas.

Representative GRIFFITHS. So that if you have no ceiling on homes and it is a guaranteed loan, you are either going to raise the rates for everybody else or put them into the homes?

Mr. ROCKEFELLER. I do not think you raise the rates for others, but I think you would tend to have more money flow into homes than you would if you had the artificial ceiling.

Representative GRIFFITHS. At least those who wanted money desperately for other purposes would offer higher rates of interest.

Mr. ROCKEFELLER. And, therefore—if that is true—more money would flow into other areas.

I am simply saying that having the ceiling tends to discourage money from flowing into housing.

If you do not have the ceiling, and allow the interest rates in housing to reach their natural level, this will tend to increase the money flowing into housing as opposed to competing areas.

Representative GRIFFITHS. I think, however, that one of the members of the Commission who has appeared here has pointed out that this was a governmental policy during the past few years in times of boom to stop the building of homes, and that in times of depression or recession, to increase the building of homes.

Now, if you take that lever off, it seems to me that you would create considerable inflation in interest.

Mr. ROCKEFELLER. The suggestion of the Commission in that regard was that there would be other ways of discouraging homebuilding, such as larger downpayments and less favorable terms, and that these other methods would be preferable to an artificial interest rate ceiling.

I think that is the recommendation.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Mr. Rockefeller, are you satisfied with this report of 282 pages, that it has fully and completely gone into all the major questions, and are you satisfied with it, or do you feel that there should be some further study and investigation made?

Mr. ROCKEFELLER. Mr. Chairman, it would be hard to say that anyone could be fully satisfied with a report dealing with a subject as complex and difficult as this one, and I would hesitate to say that I am fully satisfied.

I am satisfied that the Commission devoted itself as energetically, enthusiastically, and conscientiously as it could; that it employed the best staff that it knew how to find; and that it arrived as best it could to a meeting of minds on the important issues as we saw them; and I believe, really, that is all one can ask of a human commission.

So that while not fully satisfied, I feel that it was a good job, given the nature and magnitude of the task.

Chairman PATMAN. Do you feel that the commercial banks of the country are doing their job adequately over the United States?

Mr. ROCKEFELLER. Mr. Chairman, again, there are 14,000 of them, and I am sure some are doing a better job than others.

Chairman PATMAN. 13,560, I believe, to be exactly correct.

Mr. ROCKEFELLER. I stand corrected.

Chairman PATMAN. I am not correcting you. I just happen to be informed on that in the last day or two.

Mr. ROCKEFELLER. Good.

Chairman PATMAN. The point, though, is that 40 years ago we had over 32,000 banks. I thought it was 31,000, but it was 32,000.

Does it not seem rather odd to you that during the greatest growth in our country, during the greatest development, when everything else has increased, including population almost doubling, at least increased 75 percent, that the number of banks has gone down from 32,000 to 13,560?

Mr. ROCKEFELLER. Frankly, Mr. Chairman, it does not seem surprising or even undesirable to me in its broad outlines, for two reasons.

(1) I think that there was more need for unit country banks in days when communications and transportation were much more limited, so that it was less easy to get from one place to another.

(2) And with the growth of industry and with the growth of large scale production, I think it has become important for financial institutions to be of a size that would be able to deal with the growing size of industry, and I think this undoubtedly has been an important factor in some of the mergers that have taken place.

Chairman PATMAN. Mr. Reuss, I believe you are the only one who has not asked any questions of Mr. Rockefeller.

We have taken a lot of his time. You have been patient with us for about an hour and 20 minutes, and we have two more witnesses, but if you would like to ask some questions, you are privileged to do so.

Representative REUSS. Thank you, Mr. Chairman.

I was detained and could not hear Mr. Rockefeller's presentation, but I would say that we of the committee are very grateful to Mr. Rockefeller for appearing here twice in one summer and giving of his time.

Thank you, Mr. Chairman.

Mr. ROCKEFELLER. Thank you, Senator.

Chairman PATMAN. Senator Javits was to be back.

Senator PROXMIRE. May I ask just one more question, Mr. Chairman?

Chairman PATMAN. Yes; go right ahead.

Senator PROXMIRE. The SBA, which, of course, makes the relatively short-term loans to small business has requested a much larger authorization, and they have greatly increased their rate of loans in the last 6 months.

It is an unprecedented increase.

In view of what you said to the committee earlier, it seems that you feel that there is no real gap in this area, the SBA area; that is, loans of 5 years, maybe 10 years at the most; but that it is the longer term more than 10 years where the gap exists.

And if the Congress feels that they should cut back on Federal outlays in this period, on the basis of your testimony, it would seem that this might be one area where we could do so.

Mr. ROCKEFELLER. I certainly feel, speaking as a commercial banker, we are not in a position to make the long-term loans, and I do feel that it is not only long-term loans, but, even more, equity capital and management which is lacking in many of these small businesses and, as I said, and I do not know that the Small Business Administration is as well able to deal with that problem.

But I do feel that small companies that have adequate capital and good management will not have difficulty in getting short and medium term credit.

Senator PROXMIRE. You see, the SBA, much of its program is where the bank takes 10 percent and SBA will take 90 percent.

On that kind of thing the bank feels it is sound, at least to the extent of making investment. But where you have a small bank, even a small business making a $100,000 loan, this may be too much of a commitment for one small bank.

Do you feel that there, there is a gap, or that they can turn to their correspondents?

Mr. ROCKEFELLER. I was just going to say that normally this would be the way it would happen. Many of our correspondents turn to us for participations in loans where the amount required is larger than a small bank is able to take care of.

We frequently do participate in that kind of loan, and I really am not aware that there is any credit gap on that basis where there is proper credit justification for the loan.

Senator PROXMIRE. Thank you.

Chairman PATMAN. Thank you very much, Mr. Rockefeller. It is very nice of you to give us the benefit of your views and also the views of the Commission you have served on.

Mr. ROCKEFELLER. Thank you.

Chairman PATMAN. We have as our witnesses Prof. D. Gale Johnson, and Prof. Ernest M. Fisher. I will ask both of them to come up, please.

Professor Johnson, I believe you have a prepared statement, and you have one, too, Professor Fisher; you have a prepared statement.

We are glad to have you gentlemen, and I believe that Professor Johnson is first. You may proceed, sir, in your own way.

STATEMENT OF D. GALE JOHNSON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. JOHNSON. Thank you, Mr. Chairman. I might ask whether you would prefer me to summarize my statement.

Chairman PATMAN. I think it will be preferable in view of the lateness of the hour.

Mr. JOHNSON. Yes.

Chairman PATMAN. And considering the fact that the House is in session, and we will have to leave shortly, we would request that you put your statements in the record and summarize them, please. Will that be satisfactory?

Mr. JOHNSON. Yes.

Chairman PATMAN. Without objection we will do that. They will be placed in the record.

Mr. JOHNSON. Thank you; that is the way I will proceed.

I do want to comment at the outset that the area I wish to make comments on is restricted to the Federal agricultural programs since this is the major area on which I feel I am competent to voice an opinion.

With respect to what I consider to be the three major recommendations of the Commission in the agricultural credit field, I find myself in quite complete agreement with the Commission on Money and Credit.

These major recommendations, as I view them, are the following: The first the establishment of a limited self-supporting Federal insurance program for farm mortgage loans, which would feature low downpayments, long maturities, and possibly limited amortization, with the major purpose of the loans being that of aiding in the establishment of economic-sized units.

Their second recommendation, which I also support, is the establishment of a Federal loan insurance program for intermediate term credit of 3 to 10 years to assist those farmers in financing the acquisition of capital assets other than real estate that may be required for an efficient farm unit.

Finally, the other recommendation is that the various interest rate ceilings or limitations that affect agricultural credit should be removed.

Before summarizing very briefly my reasons for supporting these recommendations, there are two other brief comments that I would like to make. First of all, I feel that the Commission in its appraisal of the accomplishments of the federally sponsored credit agencies gave them credit for accomplishing more than I think can be objectively substantiated.

The major accomplishments of the Federal land bank system, as I see it, was the introduction of the amortized loan, which has now become a feature in many credit programs, including the housing field, and the lengthening of the terms of farm mortgages which were predominantly 5-year instruments or less before the establishment of the Federal land bank system, and have since lengthened substantially.

But I do not feel there is objective evidence to prove that the land bank system has had much impact on interest rates either on the average in the Nation as a whole or differentials among regions.

The other comment about the Commission's report, and I think in many ways Mr. Rockefeller's statement this afternoon, put this issue in somewhat more appropriate focus than the report did, namely, that in introducing new credit programs in agriculture, I feel we are confronted with a real dilemma.

The real dilemma here is that in introducing new credit programs we must be aware of the fact we now have a substantial surplus problem in agriculture, and that if additional credit is made available to agriculture without sufficient effort being made to deal with the surplus problem, we may only make our adjustment problems more difficult.

There was another area where the Commission did not make a positive recommendation on, but suggested, further consideration should be given, namely, the use of credit as a means of aiding in the transfer of resources, mainly labor out of agriculture, and while I do not think that we have enough knowledge today to be certain that credit can be used in this way effectively, I would argue that consideration might be given to certain types of loan programs which would aid those farmers who wished to transfer to nonfarm jobs, aid them in making the transition more easily and at less cost and difficulty for themselves.

The two suggestions here were that at the time the farmer wishes to sell his assets as a means of getting started in nonfarm communities, loans might be made available to him to aid him making an orderly movement out of agriculture.

The second type of such program that might be considered would be the availability of long-term, low-interest rate loans to help farmers become established in a nonfarm community.

I will now very briefly say a few words about why I do support the three recommendations that I referred to earlier.

If there is, in the terms of the Commission on Money and Credit, a credit gap in agriculture today, I feel it probably exists in two areas that the Commission recommendations referred to, namely, that of aiding farmers who are now operating units that are, perhaps, too small for them to obtain an adequate living, or an income as high as they might achieve elsewhere, to allow them to get control of the necessary assets in terms of property, real estate, land, and equipment.

These loans tend to be relatively high-risk loans and thus, if such loans are to be made available for the establishment of economic sized units, an insurance program would probably be necessary and desirable.

At the present time, the major institutional lenders, the banks, insurance companies and the Federal land bank, do not finance most real estate transfers. These are actually financed by noninstitutional lenders, such as the seller and other individuals, and such financing may be quite difficult to obtain where the size of the unit to be established is larger than what is ordinary in the community.

The other of the recommendations for insurance programs represented a program for intermediate term loans. It is beginning to be true now that the amount of livestock and equipment and machinery required for an efficient-sized family farm is running into the thousands or tens of thousands of dollars in many parts of the country, and it might well be that an insurance program here would make such funds available in larger quantities than for somewhat longer periods of time.

With respect to the last of the recommendations, namely, the removal of interest rate ceilings, I am not sure here that I can add too much to what Mr. Rockefeller said himself.

First of all, if the interest ceiling is effective and enforced, it is likely to mean that this particular source of credit is reduced, and the borrower may be forced into another type of credit institution where he must pay higher rates of interest if he feels he needs the money badly.

Secondly, particularly in the agricultural credit field, it is very easy to violate the interest rate ceiling especially in short or intermediate terms of loans; and finally in the production credit associations which are owned by the borrowers effectively—I do not know whether I want to use the word "violate"—but I will say effectively evade many State interest rate ceilings on loans to farmers which are set at 6 percent, and this is done by charging a series of fees and charges which may bring the true interest rate to somewhere around 9 percent when the legal limitation is 6, because they find it necessary in order to stay in business.

There are just two final comments I want to make, and then I will stop. These are points that are, I think, quite consistent with the tone and framework of the report. But I would like to give them somewhat stronger emphasis.

The first of these is that the legal institutional and economic framework should encourage a variety and diversity of credit sources for farmers. In other words, I think it would be most unfortunate if any actions were taken that would make farmers dependent primarily on only one or two sources of credit.

I believe that the great diversity of the institutions serving farmers in the credit field is a real asset to them.

Finally, I feel that the amount of subsidized credit made available to farmers should be limited and provided only to very carefully defined groups of farmers or under carefully defined circumstances.

Thank you, that is all.

Chairman PATMAN. Thank you.

(The prepared statement of Mr. Johnson follows:)

STATEMENT OF D. GALE JOHNSON, THE UNIVERSITY OF CHICAGO

At the outset, I wish to emphasize that I consider myself competent only to discuss the Federal agricultural credit programs. Consequently, my comments will be restricted exclusively to those institutions and the recommendations and material relevant to them presented by the Commission on Money and Credit.

In the agricultural credit field, the Federal Government has evolved two major types of institutions. The first, both in terms of time and importance as measured by volume of loans outstanding, are the federally sponsored credit agencies. These agencies, which are coordinated and supervised by the Farm Credit Administration, are cooperative institutions and are now largely owned by their borrowers. The Federal land bank system has been owned by its borrowers in its entirety since 1947, and the amount of Government capital remaining in the intermediate credit system is relatively small and has declined significantly in recent years. Government capital, in a relative sense, is now important only in the banks for cooperatives. The second type of Federal credit agency makes loans directly to farmers and is completely owned and controlled by the Federal Government. This includes the Farmers Home Administration and, if one wishes to consider it as an agricultural credit agency, the Rural Electrification Administration, which makes loans to rural electric cooperatives. In addition, it may be noted that within the Farmers Home Administration limited use is made of a loan insurance program.

I am in agreement with the recommendations that the Commission on Money and Credit has made with respect to agricultural credit programs. The major recommendations are, in my opinion, the following: First, the establishment of a limited self-supporting Federal insurance program for farm mortgage loans

featuring low downpayments, long maturities, and possibly limited amortization. The purpose of these loans would be to aid in the establishment of economic-size units. Second, the establishment of a Federal loan insurance program for intermediate term credit of 3 to 10 years to assist farmers in financing the acquisition of capital assets other than real estate that may be required for an efficient farm unit. Third, the various interest rate ceilings or limitations that affect agricultural credit should be removed.

Before indicating the reasons why I support these recommendations, I would like to present reactions on two points. One of the points refers to what has been said by the Commission and the other emphasizes more strongly a point made by the Commission.

With respect to what the Commission has said, I feel that its appraisal of accomplishments of the federally sponsored credit agencies implies far greater success than can be objectively substantiated. On page 193 of its report, the Commission gives the land bank system credit for accomplishing several things, with respect to lengthening the term of mortgages and the introduction of amortization schedules into mortgage contracts, there is no doubt that the land bank system played a major role. The system was also given credit for reducing interest rates and for reducing interest rate differentials among regions and among loan sizes. On the basis of the evidence available to me, I believe that the impact of the land bank system upon the interest rates on farm mortgages has been a very moderate one and that if there has been any effect, the maximum impact is of the order of two-tenths of 1 percent. Whether the land bank system has had much influence on regional interest rate differentials is also uncertain. The change in the pattern of interest rate differentials regionally after 1917 was quite similar to changes that occurred in the decades before 1917.

I feel that there is even less basis for attributing significant effects to the intermediate credit system. I believe that the most that can be said for the intermediate credit system is that it has provided an alternative source of credit for farmers and that it has provided a system of credit which can readily draw funds from the national credit market rather than from primarily local sources. I do not feel that there is sufficient evidence to say that this system has either lengthened the term of non-real-estate loans made to farmers or reduced the interest rates on production credit to farmers or, except for the depression period of the thirties, provided a more stable supply of loan funds.

The other point that I now wish to make turns in part upon a matter of emphasis, since the Commission did not leave the issue entirely unrecognized. I believe that any significant modification of agricultural credit programs at this time should clearly recognize the existing problem of agricultural surpluses and that credit programs which might have the effect of increasing the quantity of resources used in agriculture and would thus add to the surplus problem should not be introduced at this time. In its report, the Commission notes, though perhaps does not emphasize it adequately, a real dilemma that confronts the policymaker in the field of credit policy. For a variety of reasons, an efficient family farm will have to be much larger in the future than it is at the present time. The capital required for such farms will obviously increase and the amounts involved may become so large as to be beyond the ability of an individual farm family to acquire. Consequently, more credit may be required as the number of farms becomes fewer but their average size becomes larger. The other horn of the dilemma is that farm products are being produced in greater quantity than can be sold at prices providing reasonable incomes for farm families. A substantial increase in the amount of credit available, especially if the credit is provided on a subsidized basis, could result in an increase in total farm output and thus increase the size of the adjustment problem confronting American agriculture.

It must be recognized that credit policy can probably do little more than to "make possible the orderly transfer of capital and land resources in agriculture to larger and more efficient operating units." The Commission notes, without making a specific recommendation, that credit might be used to speed the transfer of resources out of agriculture. I feel that serious consideration should be given to at least an experimental program of using credit to help farm families to move from some of the low-farm-income areas. The Commission suggests two such programs. One is a nonrecourse loan to farmers who are planning to leave agriculture. This loan presumably would be made to farmers several months in advance of their planned departure and would be based on estimated values of

their farm assets. The nonrecourse feature would only come into play if the actual sale value of their assets turned out to be less than the estimated value. Such a loan program would be of value primarily to the farmers who have a significant amount of assets. Many of the farmers, however, who find it advantageous to leave agriculture own little real property. For such farmers a program of long-term, low-interest-rate loans to provide the funds to cover the cost of moving, the cost of subsistence during the early period in a new community, and perhaps enough to purchase a home might help to speed the flow of labor out of agriculture. The Commission's second suggestion was for loans to attract industry into low-income farming areas, and presumably the depressed areas program will operate such a loan program. Both of these loan programs involve financial risk, but the net cost to the Government over the long run could be substantially less than the farm programs that we now have.

The first two of the three recommendations by the Commission referred to above would involve the establishment of credit insurance programs designed to make it easier for farmers to achieve adequate sized family farm operating units. If farm families are to have incomes aproximately the same as nonfarm families, there is no question that there will have to be many fewer farms a decade hence and the average size much larger. At the present time, the major institutional lenders, including the Federal land banks, the insurance companies, and the commercial banks, finance only about 40 percent of all land transfers requiring credit. Legal and other restrictions prevent such lenders from providing as large a loan as most buyers of real estate require. Consequently, more land transfers requiring credit are financed by sellers than by all the institutional lenders. Farm enlargement also usually requires significant investment in capital assets such as livestock, machinery, and perhaps remodeling of farm structures. Many of these investments might be best financed by intermediate term loans, ranging in term from 3 to 10 years. Most of the credit institutions now serving agriculture are either unable or unwilling to make loans not secured by real estate for this period of time. I should note, however, that since 1955 the production credit associations have been extending a significant number of loans with terms of 3 years and that the record of commercial banks in financing loans for intermediate term purposes is substantially better than they are given credit for. Nevertheless, if commercial banks and production credit associations had an insurance program available to them, their willingness to make such loans would undoubtedly be increased.

I strongly support the Commission's recommendation that all interest rate ceilings or limitations be removed. There are two main reasons for my support of this recommendation. First, if the interest rate ceiling is effective and enforced, it is likely to mean that the particular source of credit is reduced and the borrower may be forced to another type of credit institution where he must pay very much higher rates of interest. Second, it is relatively easy to violate interest rate ceilings, especially on short and intermediate-term loans. This can be done by charging fees of various kinds, a practice, incidentally, which is followed by production credit associations, even though these are owned by the borrowers, or by requiring that part of the amount borrowed is left on deposit in a commercial bank. The policy of the Federal intermediate credit banks of refusing to discount paper for commercial banks if the margin between the discount rate and the loan rate exceeds a certain amount has meant that commercial banks have been unwilling to utilize this source of credit. In the final analysis, this limitation has probably harmed farmers rather than helped them.

There are two final points that I would like to make. These points are quite consistent with the general tone and framework of the report of the Commission on Money and Credit, but I believe them to be so important that they should be given strong emphasis.

1. *The legal, institutional, and economic framework should encourage a variety and diversity of credit sources for farmers.*—This condition is now reasonably well met by agricultural credit policy in the United States. Most farmers do have a variety of credit sources available to them and such variety is necessary if their credit needs are to be effectively met. Credit institutions organized for profit such as commercial banks, institutions organized cooperatively, such as land banks and the production credit associations, and governmentally owned and operated credit agencies such as the Farmers Home Administration tend both to compete with each other and to complement each other. This recommendation is certainly consistent with maintaining and encouraging the land banks and

the production credit associations and the intermediate credit bank. The recommendation is inconsistent, however, with any measures that would aid the federally sponsored agencies to become the dominant element in the supply of agricultural credit. One may conclude, both from their structure and their past history, that the federally sponsored agencies do not have sufficient flexibility to provide all or even most of the credit used by farmers. Both the land banks and the production credit system have found it necessary or desirable to standardize their operations to a very substantial degree, but the credit needs of farmers are very diverse and cannot be met by a limited number of forms of credit. The extent of standardization has probably resulted primarily from two influences. First is the practice of having a single rate of interest on all mortgages written by each land bank and on all loans made by each production credit association. The characteristics of these institutions make it extremely difficult for them to charge varying rates dependent upon the size of loan, the degree of risk involved, or the term of loan. The second element leading to standardization is a result of one of the great strengths of these two institutions; namely, their ability to obtain funds from national credit markets. Relatively low-risk farm loans may well be required to sell bonds or debentures at atractive rates.

These comments about certain characteristics of the federally sponsored credit agencies are neither meant to degrade those agencies nor to imply that they do not play an important or necessary role in agricultural credit. Each of the other agencies have significant limitations and no one of them could serve all or most of the credit needs of agriculture. Commercial banks have legal and ideological limitations that would prevent them from becoming an important element in the supply of long-term credit to agriculture. The fact that individuals play such an important role in the provision of credit for real estate transfers indicates that there is an important sector of the mortgage credit market not now being filled by the institutional lenders as a group.

The purpose of the remarks about the federally sponsored agencies was to underscore another point; namely, that subsidies should not be used to allow or encourage the cooperative agencies to expand their share of the farm loan business. The past history of these organizations, especially since 1940, does not imply that either one of them has any intention of expanding their role by the use of governmental subsidies. The Federal land banks have already repaid all of the governmental capital invested in them and the production credit system is making rapid strides in the same direction. Certain elements of subsidy or special treatment still prevail while the production credit associations are subject to all State and Federal income taxes and all other State and local taxes applicable to any business. The franchise taxes paid by the intermediate credit banks are probably less than a private business firm would pay on the same earnings and in any case the franchise taxes are perhaps more appropriately considered as a flexible payment of interest on governmental capital than as a tax.[1] The Federal land banks pay very few taxes. The land banks and land bank associations are not subject to the Federal income tax, nor to State and local income taxes and Federal land bank bonds are still exempt from State and local income taxation, though subject to all Federal income taxes. Since other financial institutions such as insurance companies do receive special Federal income tax treatment, it is not at all certain what would constitute fair and equitable taxation of the land banks and of the intermediate credit banks. Yet the implicit subsidy involved here is probably important enough to warrant removing whatever competitive advantage may be derived from the current special treatment.

2. *The amount of subsidized credit made available to farmers should be limited and provided only to carefully defined groups of farmers or in carefully defined circumstances.*—Farmers as a whole can obtain no longrun gain in gain in income from low, subsidized interest rates. Existing owners of land can realize a capital gain from a lowering of the interest rate, but individuals who purchase land subsequent to the lowering of the rate would gain nothing from the existence of a low, subsidized farm mortgage rate.[2] Any monetary gain that farmers

[1] The franchise tax paid by the intermediate credit banks is equal to 25 percent of its earnings remaining after it has allocated 25 percent of those earnings to a reserve account. However, the maximum amount of the franchise tax is equal to the amount of Government capital invested in the banks, multiplied by the average rate on all U.S. Government obligations issued to the public during the preceding fiscal year.

[2] In fact, the farmer with limited capital finds it more difficult to purchase land when interest rates are low because of the increase in the absolute amount of equity required.

might realize as a result of reduced interest rates lowering the expenditure upon borrowed credit would be rather promptly offset by a reduction in the return on the capital resources that they themselves owned. This would come about as a result of increased agricultural output and redudction in the prices of farm products. In addition, a subsidized interest rate would lower the demand for labor and result either in a reduction in farm employment or a lowering of the return to existing workers in agriculture. Only if credit were rationed so that the amount used at the lower interest rate were not greater than before would farmers gain an amount equal to the reduction in the interest cost. Such rationing would not only present insuperable administrative difficulties, but would also introduce significant inequalities within agriculture and result in economic inefficiency.

Chairman PATMAN. Since our next distinguished witness is a graduate of the University of Wisconsin, and possibly the Senator from Wisconsin would like to present him, I will ask him to do so.

Senator PROXMIRE. Well, I am delighted to do so.

Dr. Fisher, I am very proud of the fact that you not only are a graduate of Coe College and Northwestern, but also of the University of Wisconsin.

You certainly honor us. You had a very, very distinguished career, very broad and wide career, and you certainly have greatly contributed to your country and to your Government, and you certainly do us great honor in appearing before us.

I understand you are retiring, which will be our loss, but certainly you have earned your retirement, and we are most honored and happy to have you before us today.

I am most grateful to the chairman of the committee in permitting me to say a few words of greeting.

Chairman PATMAN. You may proceed in your own way, sir. Your statement will be put in the record or you may summarize it if you desire, any way you want to proceed.

After you have finished we will interrogate both of you.

STATEMENT OF ERNEST M. FISHER

Mr. FISHER. Mr. Chairman and Senator Proxmire and Mrs. Griffiths, I am very much touched by your remarks, Senator. I remember the University of Wisconsin with much pleasure, for I not only received a degree there but I also met my wife there, when she was an instructor in the Department of English.

I was successful in persuading her to take the "Mrs." instead of the PhD degree, an achievement that is greater than almost any other to which you have referred. [Laughter.]

It is a pleasure, sir, and a distinction for me to be able to come and testify before this committee, and the invitation to do so is an honor which I appreciate very much.

I only regret that the invitation came when my time was so committed that I have not had time to prepare a statement which is worthy of the dignity of this committee.

The statement which I have submitted is a very hastily prepared one, and I prepared it with the intent of making my statement as compact as I could so as to save the time of the committee.

I think, therefore, that I had better read the statement than attempt to condense it further with extemporaneous remarks.

With the recommendations of the Commission regarding Government policies and programs concerning the use of credit in con-

nection with urban renewal and housing, there is probably more room for agreement than for disagreement. There is little ground for opposing continuation of the Federal Housing Administration loan insurance programs, for example. Anyone who has examined the voluminous statutes and regulations under which these programs operate would welcome any simplification of procedure and regulations, and any consolidation of programs that could be reasonably effected, and some of these are suggested by the committee report.

There might be some disagreement on the recommendation that the voluntary home mortgage credit program and the certified agency program be expanded without some further study of the results which have so far been obtained from these programs, and of some of the problems which have been met.

Differentiation of the functions and operations of the Federal National Mortgage Association as recommended would meet with widespread approval.

There are three major topics, touched upon but not elaborated in the report, which are relevant to my assignment:

1. The difficulty of designing and executing a Federal credit program in such a way as to make it an appropriate means of attaining a multiplicity of purposes or objectives which may be at least partially contradictory.
2. The problem of adjusting or adapting Federal credit programs and policies to changing political, social, and economic conditions.
3. The problem of obtaining optimum or maximum results from the use of Government funds or credit.

To each of these questions I should like to address at least some questions to which it seems additional thought must be given. Obviously it would be helpful if the thought of a body as able and significant as the Commission on Money and Credit would study these questions.

The emphasis in the report is upon the use of Federal credit programs as a means of securing a "reallocation of resources." While this is an important objective of any program of Federal expenditure or provision of credit facilities, in the fields of housing and urban renewal it cannot be accepted as the sole objective, and there are many who would challenge it as the major objective. The Commission has recognized this, but has not emphasized the problems which this multiplicity of objectives implies.

> An appraisal of the appropriateness of the objectives of the program was not made * * * the effectiveness of the types of credit activities established to accomplish the purposes sought and the methods by which they are financed in relation to our major national economic objectives—

however, was examined. Specifically, most of the analysis and recommendations of the Commission in these areas appear to have been directed toward the effectiveness of these programs in stimulating or diminishing the volume of residential construction.

> A credit program reallocates resources only insofar as it increases the credit available to specified borrowers, reduces his cost through lower interest rates and easier terms, or both.

This statement seems to recognize that one result of a credit program may be not to reallocate resources from the production of one type of goods to another, but to reallocate the product from one consumer, or type of consumer, to another.

This illustrates the difficulty of using a credit program to achieve a given purpose. For the benefits of a credit program designed for the consumer may reach him only by passing through the hands of a number of intermediaries. Specifically, the credit programs in housing are designed and have been modified from time to time primarily to make housing available to the consumer at a periodic outlay or expenditure which is at a minimum. The programs have operated in the postwar period primarily as stimulants to the production and sale of new single family houses to owner-occupants. In the boom of the 1920's, for example, single family houses accounted for between some 60 percent of total residential units constructed. Through the boom since 1947, they have accounted for well over 80 percent.

But there is some question as to whether the credit and the terms made available to the purchasers of new homes have resulted in any considerable advantage to them. For the reduction in periodic payments which have been presumably accomplished by the liberalization of mortgage terms have reached the owner only, if at all, through the intermediary of housing markets.

The limits of time prevent my elaboration of the characteristics of these markets which may have interfered with the achievement of this objective. I can only mention that among these characteristics is the durability of the product of the housing construction industry. Some 90 percent of the volume of production is for additions to inventory rather than for replacement of items that disappear from the inventory in the hands of the consumer. This is almost in opposite proportions to the product of many other segments of our economy, in which 90 percent of the production is for the replacement of items that disappear from the market.

One of the serious implications of this market phenomenon is the unresponsiveness of the relationship between supply and demand to changes in prices and rents in housing markets.

There is serious question whether the increase in purchasing power intended to reach the consumer has not been at least in part absorbed by the rise in prices and costs of construction in the postwar period. A significant contrast between the housing markets of the post-World War I and post-World War II periods is this: There was little change in the cost of construction index from 1923 to 1929. From 1946 to 1961, however, this index has increased by a much larger proportion than has the consumer price index. Both indexes were relatively stable in the 1920's. It may be that the more liberal mortgage terms of the post-World War II period are partly reflected in this disproportionate housing construction cost index increase in the post-World War II period.

If this be the case, then the liberalization of mortgage terms which has been effected in the postwar period principally by legislation, has resulted in profits to the builder and to the sellers of old homes, of which there are about two for every new house sold; and, incidentally, about 60 percent of the credit used in the housing market is for the exchange or sale and purchase of existing homes rather than for the construction of new homes.

As has been indicated elsewhere—this is in a report which I made for a Government agency some time ago—effective action programs must be adapted to changing social and economic conditions.

The FHA and the PHA were established when unemployment was rampant. Building was almost at a standstill. Incomes had skidded to low levels and for many households had completely disappeared. Vacancies were high in all types of facilities; the rate of utilization was at a low level. Costs of building were steady or declining, and prices and rents had fallen by significant amounts.

Several of these conditions had changed by the time the urban renewal program was inaugurated in 1949. Unemployment was much less, incomes had risen, and the increases had been widely diffused. There was a shortage of building labor in most trades. Pressures on the supply of housing and other real estate facilities had become more intense. Vacancies had virtually disappeared. With a record percentage of married couples "doubled up"—that is, sharing the same dwelling unit with the parents or another married couple—the rate of utilization of the standing stock was probably at the highest point in more than two decades, if not in history.

Costs of construction had risen steeply in the postwar period and rents and prices were also rising. The rate of increase in population was at a low level during the thirties, but rose during World War II and during the postwar period. The rise reflected a rapid increase in the birth rate and a large increase in the number of children born per married woman of child-bearing age. The number of marriages reached an alltime high of 1,800,000 in 1948.

During the course of "the fabulous fifties" many of these conditions changed. A historic record was made in adding over 15 million dwelling units to the standing stock; the number of "doubled-up" families has been reduced from nearly 3 million to less than 1.3 million; the appearance of a considerable vacancy count in several areas—

the last one by the Census Bureau was 8.3 percent of the stock of rentable quarters—

gave the impression that the rate of utilization of the standing stock has been gradually but steadily declining. Costs of building and rents and prices continued to rise throughout the decade—

and have continued to rise throughout the 1960's.

The marriage rate and the rate of increase in the population both declined.

Despite these radical changes, there have been only minor adjustments of the programs under the supervision of the Administrator of the Housing and Home Finance Agency.

Since these various programs were initiated, each for a specific purpose, the means which each employs has been used primarily to accomplish its limited purpose * * * but little effort has been made to adapt the means designed to serve one purpose to other purposes. Actually, few experiments have been tried in the interchange of means to accomplish the various purposes. What attempts have been made have not always been happy in results.

The FHA mortgage insurance, designed to induce private funds into the market so as to increase both the total amount of available funds and to facilitate the geographical flow of funds, has also been used as a means of inducing the flow of private funds into more risky mortgage investments—for "a social purpose," as it is sometimes put. FNHA, intended as a secondary market for FHA and veterans' insured and guaranteed loans, has been used as a masquerade for direct Government loans. That is, FHA has been performing some of the functions of subsidization of housing costs, and FNMA has been performing as a vehicle for lending Government funds as well as a secondary market for mortgages made with private funds.

It is claimed in some quarters that FHA section 220 and 221 mortgages are currently being used in situations in which private funds are not appropriate and that a form of subsidy is involved. Public housing in some modified form is suggested as the solution to problems of middle-income groups, under the pretense that if public funds are used to make loans at lower than private market rates no subsidy is involved.

A much more thorough study should be made than heretofore of the function of the different means used by the various agencies, with a view to delineating more clearly the situations into which they fit and the appropriateness of each means to the various purposes of the Congress and of the Nation.

One real question regarding the use of Government funds or credit in any program to achieve any objective must always be that of efficiency or value received for the expenditure.

The credit programs commented on by the Commission and centered in the Housing and Home Finance Agency are not examined in the Commission's report from this point of view.

It has been held that more value could be obtained from the expenditures on those programs if they were more effectively integrated.

Integration and coordination are needed, it is claimed, at both the Federal and local government levels. As has been indicated elsewhere in the same report to which I have previously referred:

> Regulations, standards, and other operational details of the agencies in the HHFA should be as nearly identical as their different functions will permit. Conflicts should be eliminated and, for the most part, regluations, etc., should be interchangeable. All these agencies operate in the same market, each concerned with a different segment of that market. The intelligent performance of their respective roles in the market as a whole calls for very similar investigations and collecting very nearly the same market information. They appear before many of the same local and national groups, wrestle with nearly the same limitations, handicaps, and restrictions and are subject to almost identical pressures from private individuals and organizations concerned with the improvement of housing and the urban environment.
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> Closer integration of the programs would be facilitated by merging all the agencies into a single unit. Such a consolidated agency could probably eliminate duplication of effort, staff, and establishments both in Washington and in the field, as well as assure a more unified program of action. Local public agencies would have to deal with only one agency and secure only one approval, one clearance and one audit.
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> Unification of these agencies and programs should permit all Federal Government assistance to be consolidated into one contract of grant and subsidy.
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> Better coordination or integration at the local level can be greatly increased by two measures. The first is an expansion of the concept of "a workable program" and, second, a consolidation of local public agencies, preferably on a community-wide basis.
>
> "Projectitis" and a desire to "get our share of Federal funds" have caused communities to develop the pieces before they had designed the whole. Some have never gone beyond the project stage to develop a program into which the projects fit as parts. The requirement of a workable program has caused some shift of local attitudes in this direction. But much remains to be done to induce local communities to put time and resources into preparing a long-range, comprehensive program of community improvement.

There is a pressing need, almost emergency need, for examination of credit programs from these and other points of view. It is difficult to acquiesce in the recomemndations of the Commission on credit aspects alone of these programs. These programs are absorbing an increasing volume of governmental expenditures or attaching governmental guarantees to an increasing total from year to year at an accelerated rate. The statement of the Commission that urban renewal programs will continue to absorb an increasing volume of Federal funds is probably no exaggeration. A better understanding of the markets into which these funds are being poured, so that there can be greater assurance that the objectives of the Congress and the people are likely to be achieved in great possible measure seems to rate a high priority.

Thank you, sir.

Senator PROXMIRE (presiding). Thank you very much.

Senator Javits.

Senator JAVITS. Mr. Fisher, thank you for being here, and I welcome you as a constituent and professor of one of the most distinguished institutions of learning in my State, an area which I used to represent in the House of Representatives.

I had just one question to clarify in your statement. I notice in your last sentence you speak of the objectives of a Congress and the people. Am I to tie that in to the last sentence in the preceding paragraph which speaks of a long-range comprehensive program of community improvement?

In other words, do you find Congress and the people to be in agreement that there should be a long-range program of community improvement?

Mr. FISHER. Yes sir; I think the answer is, "Yes."

Senator JAVITS. And you say that there is a bare understanding. What would you do if we were to get a better understanding; precisely what do you recommend we do? Shall we authorize somebody to make a study or shall we have hearings? I am on the Banking and Currency Committee, and so is Senator Proxmire.

It is true that although we are both ardent supporters of housing, however much we differ in respect to detail, I have certainly, and, perhaps, Senator Proxmire has too, been concerned about this structure of buildings and improvements involving so many billions of dollars of credit and the lives of so many people, and notwithstanding the fact that we are—and I am—an ardent supporter, it does not make me any the less sophisticated in knowing what I am doing to the best effect.

So I welcome the suggestion of you, although it might not be carried out in this committee, perhaps it might be carried out in the other legislative committee which has authority over housing as to what precisely you would like to see us do.

Mr. FISHER. Senator, that is a difficult question for me to give a specific answer to. I hesitate very much to presume to say what Congress should do with respect to a given situation.

Senator JAVITS. Well, lots of others are not so hesitant. [Laughter.]

Mr. FISHER. I can only answer it honestly in these terms: These programs, and this whole area, are of fairly recent vintage. The first Federal legislation which affected these markets seriously was passed in the early thirties. There has been little objective study of these programs in operation, and there is no program of research in the Government or out of the Government covering these areas.

Since those early programs were initiated in the early thirties, the Government has taken the first major step toward a kind of examination and study of these programs that I had in mind in writing this sentence.

It authorized in 1940 the first census of housing that was ever taken in this country, and that has been repeated now at each census period, and is now a part of the regular census procedure.

These censuses give us a vast quantity of data that need very careful study to answer the questions that I have posed.

The operations of the agencies that have been set up since the early thirties in this field have provided a vast quantity of material that needs to be studied to find some answers to some of the questions which I have posed.

Precisely how this kind of investigation should be organized and carried out is not within my province to say.

I think that it might be desirable to study the relative effectiveness of expending Government funds for investigation into these fields alternatively by Government agencies and by the outside agencies who may be able to take a more objective view, particularly our universities.

Senator JAVITS. Well, of one thing you are sure, and that is before we pile in heavy urban renewal funds there ought to be some concept of where the community is going with that part of it and other parts of its programs.

Mr. FISHER. Yes, sir.

Senator, from what I have seen of the urban renewal program, and it is not very intimate, but my interest in this field has caused me to observe more closely than casually, from what I have seen of the program, its objectives are unquestionable, but its accomplishments leave much to be desired.

That is not said to criticize either the Congress in passing the legislation or the administrators who have administered it, but it is simply to call attention to the fact that we are dealing in this area with forces about which we do not know anything, because our interest in it, our efforts in the field, are of such recent vintage that we have not as yet had the opportunity to study the results of the program.

Senator JAVITS. Thank you, Professor Fisher.

I might say for the information of the committee that Professor Fisher has made some studies at my request.

Mr. FISHER. It was a great pleasure, sir.

Senator JAVITS. Well, thank you, studies of the validity of the premium rate charged by the FHA, and he is a happy man because he lived to see himself vindicated.

I thank you, Mr. Chairman.

Senator PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Professor Fisher, I was going to ask you if you considered at the present time that urban renewal program was a failure or is that too harsh a question?

Mr. FISHER. I cannot answer yes or no any more than I can that traditional question "Have you quit beating your wife."

As I have seen the program in operation it has accomplished many desirable results. But it has failed to solve the most critical aspects of the problem.

Senator JAVITS. Mr. Chairman, would the lady yield to me for a minute? I just wish to state for the record, so that the record is correct, that Mr. David Rockefeller has been excused from testifying further today, and he has felt it would be more efficient for him to send a letter to the committee, which I ask unanimous consent be made a part of the record, which will update his testimony on the subject of the international aspects of money and credit as contained in the Commission's report from the testimony he gave before the Subcommittee on International Exchange and Payments of our committee, together with any other appropriate comments he feels necessary.

Senator PROXMIRE. Without objection.

Representative GRIFFITHS. I would like to ask further, Professor Fisher, do you consider that during the past years the purchaser of a single home under the Government programs should have been getting it cheaper or better, or do you feel we have not done enough research on this to see where we are going?

Mr. FISHER. My answer is only an expression of my judgment.

Representative GRIFFITHS. Yes, of course.

Mr. FISHER. I have no statistical material with which I can support that judgment.

In my judgment, without the liberalization of terms in mortgage lending, which has been effectuated from time to time in the postwar period, the price of both new and existing houses would be lower today than it is, and in my judgment the volume of new construction of homes would have been very close to what it has been in the postwar period.

Representative GRIFFITHS. Thank you very much.

Senator PROXMIRE. I would like to ask Mr. Johnson some questions.

Mr. Johnson, a look at the Commission makeup and you have the chairman of the General Life Insurance Co., you have the chairman of the board of Pacific Gas & Electric Co., the chairman of the board of the Detroit Bank & Trust Co., the chairman of the board of the First Security Corp., the chairman of the board of Anderson, Clayton, an enormous commodity corporation down in Texas; the president of the First National Bank of Chicago, the president of the Federal Home Loan Bank, the chairman of the board of Federated Department Stores, and so forth.

We just had the president of one of the biggest banks, I suppose the biggest bank, in the world, Mr. Rockefeller, who was here a few minutes ago.

You do have representation from labor in the director of the Department of Research of the AFL-CIO.

Now, it is true that Mr. Charles B. Shuman, president of the American Farm Bureau Federation, served on the Commission.

Mr. Shuman represents an organization which is the biggest farm organization in the country, but it is a farm organization which has been generally, its policies, at least in my view, have been repudiated by the farmers at the polls repeatedly, certainly that has happened in my State, where we have the Farm Bureau which is the biggest farm organization in the State, but the Farm Bureau has taken positions contrary to those that I have taken, for example, and when I have gone to the farmers, the farmers have vindicated me and opposed the Farm Bureau candidates.

You have the same general, I won't say same general, philosophy, because I do not know what it is, but I think your statement which you have given today tends to corroborate this.

It seems to me it is unfortunate that there is not more of a clash in viewpoint on this Commission, and before the committee from the working, dirt farmers who own their little farms, and who seem to want credit and need credit. In view of the fact that that has not been represented, in my judgment, on this Commission or before the committee, I guess that will have to be my role this afternoon in the time we have left.

You say, for example, that the dilemma that faces us in farming is one which the Commission should be more aware of, that is, the dilemma that we already have a surplus, and if we make credit more readily available farmers are likely to produce even a greater surplus. That is the implication of what you said.

Mr. JOHNSON. That is correct.

Senator PROXMIRE. In the first place, I would like to ask you if this takes into account or if the Commission takes into account the fact

that our generous Federal Farm Credit programs have played a part in a perfectly marvelous increase in farm efficiency and technology in the last 15 years, far greater than in industry, much greater than in any kind of economic endeavor in this country.

This farm efficiency is, perhaps, the most decisive advantage we have over the Soviet Union. This great technological burst we have had has been identified, unfortunately, as a burden, even by the Farm Bureau Federation leaders; whereas it is in many respects a very great blessing. It subsidizes the consumer with lower food prices in this country than in any other in relation to personal income; it has resulted in tremendous efficiency advantages between this country and the Soviet Union.

Isn't it true that by having farm credit machinery of the kind we have that we particularly have enabled the farmer to move ahead technologically, to electrify, to buy equipment, to operate in the most efficient and effective possible way; and, whereas there is a burden in the Commodity Credit Corporation operations, still it is a very great advantage to society as a whole?

Mr. JOHNSON. Well, I would certainly agree with you that the rapid increase in productivity that we have seen in American agriculture certainly for the last 20 years is a real blessing.

The point that I have tried to make here though is that we should take steps to see to it that in a real sense farmers do not bear too much of the costs growing out of this improved efficiency, and that——

Senator PROXMIRE. That is what I miss in here and that is what I, of course, do not see in your statement. Of course, your statement had to be a brief statement. I do not believe I should be too critical, but that is what I missed before here, and that is the human problem.

Here is a man who works longer hours than anybody else in society does. He takes the biggest risk, he makes one of the biggest investments, $50,000 per farm in my State. He has enormously increased efficiency. His reward is that he has an income of about 80 cents an hour, which is 40 percent less than the minimum wage is going to be shortly. It just does not seem fair at all, and the recommendations that generally are made are that we should cut him down further.

Mr. JOHNSON. Yes; I do not think though that the Commission's point is inconsistently on the view of this. The Commission was arguing that if you push more subsidized credit into agriculture this is likely to hurt the farmer's income rather than to help it.

The Commission—neither the Commission nor I have asked for any restraints on the Federal land bank or on the Federal intermediate credit system or on FHA.

In fact, the two proposals for additional programs are similar to what was included in the recent agricultural bill of the insurance programs of the Farmers Home Administration.

Senator PROXMIRE. Yes. But, you see——

Mr. JOHNSON. Excuse me. The two recommendations for new measures that are made, perhaps there is no connection, I do not know.

Senator PROXMIRE. I like those two recommendations.

Mr. JOHNSON. They have already been made.

Senator PROXMIRE. I think they are very good.

Mr. JOHNSON. Have already gone into law in the new Agricultural Act.

Senator PROXMIRE. I see nothing wrong with that. But the thing is, that in spite of the fact that farm income has remained pretty low, even on a per capita basis, the price of farmland has increased, the opportunities for people to get into farming are limited and, therefore, you have to look at the people who are in farming and who are going to stay in farming, and certainly it is no benefit to them if the cost of their credit goes up because they must be such heavy borrowers in proportion to their income, as heavy a borrower as we have in our society, and the Government, by keeping cost of credit at 6 percent instead of letting it go to 7 or 8, does at least benefit them to that extent.

It may conceivably, and probably does, somewhat slow down the egress out of agriculture, and in this way, perhaps, does tend to keep conceivably a little larger farm population.

But won't you agree with me that regardless of what has happened to prices over the last 15 years, even when they have been high, even when the situation was pretty high in the farm, we have had steady diminution in the farm population?

Mr. JOHNSON. But the most important factor in the steady movement has been the employment situation in the rest of the economy, there is no question about this.

Senator PROXMIRE. It has been steady in the last 15 years.

Mr. JOHNSON. When the unemployment rate is low, the outmovement increases; when it is high, the outmovement slows down, although it has been positive every year.

Senator PROXMIRE. This is certainly an argument to push them out by making them more miserable, by pushing their interest rates up and pushing their income down, even though it is half of what it ought to be.

Mr. JOHNSON. I have not been able to devolop it fully here, but I think to some extent, to some degree, a relatively low interest rate will work out against the income of the farmer. It will result in their investing somewhat more, increasing output, and although you do have price supports, at least it is my opinion that Congress is sensitive to the size of the surplus, the amount that the Commodity Credit Corporation owns, and either cuts back on price supports, that is one possible policy, or cuts back on output which may, in effect, lower their income below what it would have been if the production were slightly less.

Senator PROXMIRE. Is it not true that this is a pretty inefficient way, though, sort of a painful way, to go about it, to increase interest rates to make it harder for him to borrow? Why not do it the way that we tried to do it in the feed grain bill, and in the wheat bill, and other legislation that we will probably have next year extending this, I hope, of where you let the farmer have a choice as to whether or not he wants to limit what he produces, the amount he produces, to operate on a quota basis, and let him vote on that, and if he does vote with a very substantial majority in favor of that, then you can afford to get a higher price, and there won't be a subsidy from the Government, because the farmer is getting his price in the market. He is getting the price where he ought to get it, in the marketplace.

If he votes against that, then he just has to take the consequences, but do it that way rather than make the credit system even harder on him than it is now.

The farmer has a very wise and a very long experience in the, not the hard hearts of bankers exactly, but the pains of having to pay the banker high interest rates over the many years.

Historically it goes back a long way, and he is very grateful and very happy for the small amount of benefit that he gets relatively out of these Government programs.

To say you should not have them any more seems to me pretty rough on him.

Mr. JOHNSON. I believe this is a misinterpretation of what the Commission said, if you will excuse me. The two major programs that the Government has in the farm credit field are the Federal land bank system and the intermediate credit system. These are Government-sponsored agencies.

Senator PROXMIRE. Does the Commission directly and explicitly denounce the 2 percent money for REA?

Mr. JOHNSON. No, they state this, at least, if I remember correctly, that they are opposed to the 2 percent or they feel at least if it is continued it should be recognized as a subsidy, and a direct budget charge made on it.

But I was speaking of loans that were made directly to farmers for production purposes, and here the two main sources are the land banks and the intermediate credit banks, and with respect to these, the recommendations of the Commission and my own definitely would be to continue them as they are now functioning and, on the whole, performing quite well.

The only specific recommendations that the Commission made with respect to these two agencies were the removal of the interest rate ceilings which, in the case of the production credit associations, has been evaded, and because they get around it by charging fees of one kind or another, and with respect to the Federal land banks where the maximum of 6 percent, this caused difficulty only in 1 or 2 recent years.

Senator PROXMIRE. It is far less evasion than there has been in housing, for example, at least far less called to my attention.

We have a lot of farmers in Wisconsin, of course, we have a lot of people who buy homes, and I received all kinds of complaints about the discounts on veterans and others.

Mr. JOHNSON. Of course, I think the interesting thing——

Senator PROXMIRE. Practically none from farmers.

Mr. JOHNSON. Farmers do it to themselves. They do in a very real sense own the production credit associations, and it is pretty hard to complain about what you do to yourself.

Senator PROXMIRE. What difference does it make if they are happy to charge themselves 6-percent-plus fees, and they pay the fees themselves, why is it better that they charge themselves 7 or 8 percent and no fees? Why is it a very significant recommendation?

Mr. JOHNSON. Well, mainly because I think in many States the associations could be prosecuted for their behavior if anybody wanted to do that.

Senator PROXMIRE. This is the technical aspect.

Mr. JOHNSON. Yes. This is a case of the State and not Federal laws which are operative in the case of production credit associations. The limitations are significant mainly in the Federal land bank system and here they have not been operative except 1 or 2 years.

Senator PROXMIRE. Why do you say the amount of subsidized credit made available to farmers should be limited and be provided only to carefully defined groups of farmers or carefully defined circumstances? The argument you have given me that they do not move off the farm because they are having a hard time, they can move off the farm because they get a good job elsewhere, how does this contribute to human well-being in view of the injustice they suffer?

Mr. JOHNSON. Well, my argument is this: Various efforts to reduce farmers' costs, either through reduced interest rates or, say, the agricultural conservation program, as another example of this, tend to increase output, and thus tend to induce or make it necessary for a larger number of people to leave agriculture than would otherwise be the case.

Senator PROXMIRE. This is your way of reducing output. Instead of letting them do it deliberately or requiring them to do it deliberately, if they do it, you would do it by hammering down, I mean by letting interest rates rise.

Mr. JOHNSON. Yes, on the grounds that it seems to me that we are not letting our left hand know what our right hand is doing, when, in a variety of ways, we take steps that induce farmers to produce more, and then have to turn around and adopt programs to force them to produce less.

Senator PROXMIRE. We know very well what our right hand is doing, and we like it that way.

I think the Congress and the farmers know what this amounts to in most of these areas. But if you can show that there is a frictional inefficiency, and the cost is a cost borne by both the farmer and society, that it does not really benefit anyone, I think you have got a strong argument. But if you simply say, as you say, that this is a way of reducing output——

Mr. JOHNSON. And increasing farmers'——

Senator PROXMIRE. I think that ought to be done deliberately on a democratic basis of letting them decide whether they want to do it or not in order to get the benefits.

I would like to just finally ask Professor Fisher—I certainly enjoyed the statements of both of you gentlemen very, very much, it was a very fine contribution.

I think, Professor Fisher, if you could comment on the emphasis that Mr. Rockefeller gave and the Commission on Money and Credit gives, to knocking out ceilings, this is something which has troubled Congress a long time, ceilings on FHA and VA interest payments. Do you concur in that that it should be eliminated?

Mr. FISHER. I think that the objective of Congress so far as the objective of Congress in enacting the basic legislation which governs the operations of both the FHA and the VA home loan program, to the extent that that objective is to make funds available on terms which the purchaser of the home can meet with some assurance of continuing to meet them, that the removal of the ceiling would be desirable.

To the extent to which it is the objective of Congress to control the cost of those funds to the borrower, of course, the ceiling should be retained. There is a distinction.

Senator PROXMIRE. Do you think on the basis of your experience that the ceiling does control the costs of the borrower, or do you think he has to pay discount points and that, in effect, he is paying about the same amount of interest that he would pay if he did not have the limitation?

The two schools of thought are first that it does have some effect on it. This is the school of thought that many people in Congress have.

On the other hand, I do run into a lot of real estate people who have a lot of experience and also have an interest on this side who claim it does defeat its purpose. The discounts are a point of friction, and it discourages home buying and building, and this results in his paying as much as he would pay anyway.

Mr. FISHER. Senator, so many of these statements are made on the premise that the purchaser is going to purchase a new house that it is very difficult for me to generalize.

I think the discounts have prevailed very largely in the field of new housing, and have been a part of the price which the builder receives for the new house.

Senator PROXMIRE. I see. But as far as the 60 percent, what did you use, the statistics you used, on the number of houses sold that are old houses or at least not new houses?

Mr. FISHER. Our statistics are not very adequate on the point.

Senator PROXMIRE. But they are more than half.

Mr. FISHER. It is about two old houses that are sold for every one new house.

Senator PROXMIRE. Two-thirds.

Mr. FISHER. You see, a new house——

Senator PROXMIRE. On these you say the discount——

Mr. FISHER. On the old house, I think the discount has not operated to the disadvantage of the borrower.

Senator PROXMIRE. I see.

Mr. FISHER. So much as it has on the new houses.

Senator PROXMIRE. This is two-thirds of the market.

Mr. FISHER. That is two-thirds of the market.

It is difficult, very difficult, to generalize about these markets and what has happened in them because many of our series, statistical series, do not distinguish between the old house and the new house.

Now if I may illustrate this point, I would like to refer to one aspect of these markets which seems to me to be unique or almost unique.

The price which can be obtained for a new house or an old house is largely a function of the relationship existing at the moment in the particular local housing market between demand and supply.

If it is a seller's market, which we have had in most communities in the whole postwar period, the price is not determined by the cost of building a new house, it is determined by the price at which houses are selling in the market, the price which the purchaser will pay or can pay or the purchaser who can bid the highest price will pay for a limited number of houses that are on sale.

Well, the new construction provides about, on the average for the country as a whole, about 4 percent addition to the supply each year maximum, although in some local communities it has gone as high as 10 percent a year in the postwar period.

Now the seller of the old house is an individual who has got a larger or smaller equity in the old house; he profits from rising prices, he gets what he thinks or his broker tells him he can get in the market for his equity.

The price that he can get in the market, actually demonstrated in the market, determines largely the price which the builder puts on his product. He does not build until that price rises to a point where he thinks he can make a profit, and that continues.

The price of the old house continues to rise, the price of the new house follows it, the cost of construction tends to follow and not to lead the prices received in the market for existing houses.

This is unique because of what I refer to in my written text as the proportion of new construction which is intended for replacement in the market, and the portion which is for additions to inventory; and about 90 percent of new construction is for additions to inventory rather than to replace items in the standing stock which disappear, like shoes, for instance.

Most production of shoes is for replacement of shoes that wear out on the feet of the consumers. But most of the production of houses is for additions to inventory and not to replace items that have worn out, disappeared from the market, and this complication in the market has caused a very rapid rise in price of the whole standing stock and has caused a demand for mortgage funds which is fantastic.

Senator PROXMIRE. Can you supply me, I think it probably would not be necessary for the committee, but if you can supply me with any information you have, any study, indicating that in this two-thirds of the sale of houses which are not new houses, new construction, that the discount is not paid, I would be very grateful for it because this is a recurring argument that comes up. It is going to come up again and again and again in Congress. It comes up several times every session, and I have never heard it before, it is a very telling point.

After all, you can talk about two-thirds of the market, and if you can argue that two-thirds of it, there is not a discount, I think this is a decisive point.

Mr. FISHER. I do not think I can give you any statistics. The FHA might be able to, Senator, but my statement was based upon my observation that the price of an existing house is not usually affected by the terms which the borrower has to pay in the market for borrowed funds.

Senator PROXMIRE. I see.

Mr. FISHER. Any difference between what he can borrow on the first mortgage and what he has to pay is very commonly absorbed in a second mortgage taken back by the seller.

Now this prevents a discount. If he gets an FHA mortgage the discount on that mortgage is prevented from being incorporated into the price of the existing house, but not so with the seller, with the builder, who is selling a volume of houses. He prices his house so as to incorporate into the price the discount that he has to take on the first mortgage if it is insured by the FHA or the Veterans' Administration. That is the basis of my statement.

Senator PROXMIRE. Yes. But, of course, the house, when you buy a house, the fact is that the price of the house is a recognized factor, it is competitive. There are other houses that you can choose to buy.

You can buy an old house if you want to. The fact that you know the price, it seems to me, acts as a limitation on the power of the builder to simply transfer the discount to the price of the house. At least he knows he is paying more, and that is all we can ask anyway of the consumer. There is nothing to prevent the builder, for that matter, from increasing the price of the house and charging an endless profit except that he knows he is in competition. He knows if he does, the buyer will say, "I don't want to buy a house," or "I want to buy another house, this is too high." If you force him to put it into the price of a house, it seems to me that is all we can ask in the competitive system.

I would like to ask one more question of Mr. Johnson, if you can supply me with any information at all that these ceilings are being avoided, any statistical substantiation of the charge which, I think, has generally been made here that the ceilings are avoided by the payment of fees. That would be very useful, too.

Mr. Johnson. Yes.

Senator Proxmire. This is another area which comes up before the Agriculture Committee of which I am a member, too. There is constant contending on that score.

Mr. Johnson. I might say, just to repeat, that the major ceilings that are avoided are not those of the Federal law but those of the various State laws.

Senator Proxmire. I see.

Mr. Johnson. Not the Federal.

Senator Proxmire. Very good. Thank you, gentlemen, very much. Your statements were very enlightening and they were appreciated.

The committee will stand in recess until tomorrow morning. We will have a panel of Mr. J. Cameron Thomson, Mr. Stanley Ruttenberg, Mr. Christian Sonne, Henry Wallich, and Paul Samuelson.

(Whereupon, at 4:30 p.m., the committee adjourned to reconvene at 10 a.m., Friday, August 18, 1961.)

REVIEW OF REPORT OF THE COMMISSION ON MONEY AND CREDIT

FRIDAY, AUGUST 18, 1961

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

The joint committee met, pursuant to recess, at 10 a.m., in room G-308, New Senate Office Building, the Honorable Wright Patman (chairman) presiding.

Present: Senators Douglas (cochairman), Sparkman, Proxmire, Pell, Bush, and Javits; Representatives Patman, Reuss, Griffiths, and Curtis.

Also present: William Summers Johnson, executive director, and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN. The committee will please come to order.

The committee is continuing hearings on the report of the Commission on Money and Credit.

Today the topic is a rather broad one in which we take up economic goals and questions of coordination.

We had hoped this morning we would be able to have a panel discussion on these topics. We had also hoped we would be able to hear in the course of these hearings from the farm and labor representatives on the Commission on Money and Credit. Accordingly, we invited Mr. Charles B. Shuman, president of the American Farm Burean Federation, to give his comments, and we also invited Mr. Stanley K. Ruttenberg, director of the department of research, AFL-CIO to give us his comments.

Unfortunately, however, neither Mr. Shuman nor Mr. Ruttenberg is able to be here.

This morning, Mr. J. Cameron Thomson, who is the retired chairman of the Northwest Bancorporation, will present the Commission's recommendation, after which, like the other witnesses, he may wish to express his personal views.

Following Mr. Thomson's testimony, we will then hear from Mr. H. Christian Sonne, who is chairman of the National Planning Association, and also Vice Chairman of the Commission on Money and Credit.

Mr. Thomson, we are glad to have you, and I believe you have a prepared statement.

I will yield to Senator Bush who would like to make a statement first.

Senator BUSH. Mr. Chairman, first I want to welcome my very old and distinguished friend from Minnesota here. We saw a good

deal of each other during World War II, but not nearly enough since then.

I am delighted to say that I have followed his able career in the business world and also am familiar with the many services he has rendered as a citizen to the social, political, and economic life of our country.

Mr. Chairman, I want to express my very deep regret that I have been unable to attend some of the sessions of this committee this week. When the chairman very kindly discussed with me the schedule and fixed these dates many weeks ago, I agreed that it would be a good time to hold the meetings, the hearings.

Unhappily, we have run head on into a conflict with perhaps the most important bill before the Congress of the whole year. Certainly it is a very important one, and I have been somewhat involved in some of the issues connected with the foreign aid bill, and I must continue to be on the Senate floor most of the time in connection with this debate.

So I wanted to express to the chairman and members of the committee my deep regret that I am unable to be here. I think the same could be said on behalf of my colleague, Mr. Javits, who is very much involved in the foreign aid bill, and Senator John Butler has been ill in the hospital all of this week, so that we have not been as well represented as we should be. I take it that Republician Members of the House, Mr. Curtis and Mr. Widnall, are also faced with the same dilemma.

So I certainly hold the chairman blameless for colliding with this big debate, and I realize that it is embarrassing to him, too, perhaps.

Nevertheless, I must say that I shall not be able to attend today to the business at hand, and I am very sorry that such is the case.

I will try to catch up with the testimony through the record when it is made available.

I thank the chairman for this opportunity.

Chairman PATMAN. Thank you, Senator Bush.

We realize the situation. We have the same situation in the House.

Senator BUSH. Yes; I know.

Chairman PATMAN. Both bills are going on at the same time. It has seldom happened that way. This morning the Senate meets at 10:30, and the House meets at 11 o'clock. We are in a situation we could not anticipate, but we are getting some very valuable testimony.

Senator BUSH. That is right.

Chairman PATMAN. And although we will not get to interrogate these gentlemen this morning as much as we would like to, their statements will be filed in the record, and we will get permission from them, I hope, to submit questions in writing, and then, Mr. Thomson, you can answer them when you correct the transcript.

Will that be satisfactory?

STATEMENT OF J. CAMERON THOMSON, RETIRED CHAIRMAN OF THE BOARD, NORTHWEST BANCORPORATION, AND MEMBER OF THE COMMISSION ON MONEY AND CREDIT

Mr. THOMSON. Very satisfactory; yes sir.

Senator BUSH. May I ask a question, Mr. Chairman?

Is it your intention at the conclusion of these hearings that a report on the report of the Commission on Money and Credit will be prepared by the Joint Economic Committee?

Chairman PATMAN. We have not decided that yet. I will consult with you first, the ranking member of the committee, and then if we decide to do it, if you and I think it is all right, we will take it up with the committee, but we will come to some resolution on that ourselves first.

Now, Mr. Thomson, if you will summarize your statement so we can get through by about 10:30, if you please; that is, in about 20 minutes.

Can you do that, Mr. Thomson? Will that be asking too much of you?

Mr. THOMSON. The trouble is this is very tightly written.

Chairman PATMAN. Go right ahead, sir.

Mr. THOMSON. My name is J. Cameron Thomson of Minneapolis, Minn. Before my retirement I was chairman of the board of Northwest Bancorporation. I appreciate your invitation to appear here today as a member of the Commission on Money and Credit to discuss the sections of the report of the Commission which deal with national economic goals, the choice and combination of monetary, fiscal, debt management, and other credit policies, and with Government organization coordination achieve these goals.

From its inception the Commission has been mindful that monetary and credit policies and measures are not ends in themselves. Like the money and credit they are designed to regulate, they are important for their effectiveness in helping us to attain basic national economic objectives.

Our national economic goals are many. But the three of central concern for monetary, credit, and fiscal policies are: An adequate rate of economic growth, sustained high levels of production and employment, and reasonable stability of prices. And the more successful we are in achieving these goals, the better able we will be to achieve our most fundamental goals: to enhance the freedom and dignity of our citizens, indeed of men everywhere, and to insure the survival of our country and its system of government. The three central goals of monetary and credit policies, however, must be sought in the context of other important national economic objectives which necessarily impose constraints on their pursuit.

A fundamental conclusion of the Commission in regard to the three goals is that, to a large degree, the attainment of one is likely to be helpful, if not essential, to the attainment of others. This basic compatibility of the three objectives is one of the most important facts about the relationships among them.

Despite this fundamental compatibility, however, the possibility of conflict among these goals is a very real one. Three problems must be recognized in their relationships. The first is that the three are

equally important as long-term objectives and ordinarily the task is to seek them all simultaneously and in reasonable degree. Second, the extent of compatibility among these goals will be greatly influenced by the measures used to achieve them. Some policies to advance a goal may serve their purpose at virtually no cost in terms of other ends, while other policies may clearly sacrifice one objective for the attainment of another. Third, and this is extremely important, monetary, credit, and fiscal measures alone will not be able to achieve a satisfactory performance in terms of all three goals simultaneously if resources move too slowly from one use to another in response to shifts in demand or if some groups enjoy and exercise substantial market power to push up or to maintain prices or wages at unduly high levels.

The Commission noted time and again that monetary, credit, and fiscal measures are essential for the attainment of the basic goals of low levels of employment, economic growth, and reasonable price stability. However, such measures probably are not sufficient by themselves for the achievement of these three objectives.

Congress should give full consideration to the necessity for preserving and strengthening workable competition in the private enterprise system in order to assure the proper functioning of the economy and efficient use of resources in response to market forces. Business and labor should exercise statesmanship in pursuing means to advance their interests. Labor unions and business should reduce unnecessary barriers to mobility and efficient production. Changes in Government policies which prevent reductions in individual prices such as farm price supports and other practices relating to stockpiling activities and other procurement practices should also be vigorously pursued.

These other measures are needed primarily because inflation may derive from other factors than excess demand. There are rigidities and market power forces in our economy which may bring inflation or which may precipitate unemployment or which may retard growth despite sound and constructive policies in the monetary, fiscal, and credit policies being pursued.

It is unrealistic to seek complete solutions to either the problems of unemployment, inflation, and lagging growth through aggregate demand measures unless other appropriate private and Government policies are pursued.

In stressing the need for other measures the Commission does not suggest that they are more important than monetary, credit, and fiscal measures. On the contrary, we believe that monetary, credit, and fiscal measures are the major governmental means available to deal with both stability of employment and the price level and their proper use is an absolute prerequisite for adequate economic growth.

While many have asserted that the structure of our economy precludes the effective use of monetary, credit, and fiscal policies, our report indicates the need for undertaking other measures lest aggregate demand measures be given an impossible task. In this sense, it is my belief that the Commission's report has attempted to redress an imbalance which leads the public to expect more of monetary, fiscal, and credit policies than they can reasonably be expected to produce.

In its examination of the relationships among the three objectives the Commission concluded that while conflicts may arise, under certain conditions, between reasonable price stability and low levels of unem-

ployment, there are no conflicts between low levels of unemployment and economic growth, and between reasonable price stability and an adequate rate of economic growth.

The relationship between unemployment and changes in the price level is fairly well understood in a general and qualitative way. An increase in aggregate demand will tend both to increase the number of jobs available and hence to reduce unemployment, but will also tend to increase wages and prices. When the level of unemployment is high, an increase in demand will have its major effect in reducing unemployment and will have minimal effects on prices. As unemployment falls, however, the difficulties increase of matching the skills of the remaining unemployed in each labor market to the jobs created by further expansions of demand. In these circumstances the effect of demand increases on wages and prices become greater. At some level of unemployment, which will vary with the changing structural and other characteristics of the labor market, further measures to reduce unemployment by stimulating demand will probably be more costly than other measures which can achieve the same reduction.

If the number of unfilled job vacancies is about the same as the number of unemployed, then unemployment cannot be said to stem from the inadequate aggregate demand. Rather the unemployment will be primarily structual, seasonal, and frictional in character. Under these circumstances the remaining unemployment and upward price pressures could be eased by governmental measures to improve the functioning of labor and product markets. While the costs in terms of Government expenditures of such measures might be substantial, it is preferable and probably less costly to bear them rather than to require policymakers to choose between the costs of rising prices of greater unemployment.

The role of aggregate demand in promoting growth has been widely discussed in recent years. The maintenance of a level of demand to achieve low-level unemployment will increase a rate of growth in several ways. First, as the economy moves to a low level of employment, there will be a rapid rate of growth during the period of change simply from hiring more workers. Second, the rate of growth of the labor force will be higher, and hence output will be higher, when unemployment is maintained at a low rather than a higher level. Finally, although a continuing low level of unemployment appears to involve little direct gain in productivity, the higher levels of demand permit other activities, both public and private, aimed at raising productivity to become more fully effective, and these effects may be substantial. Conditions of general surplus would impede the introduction of such programs. Thus, measures to stimulate aggregate demand to attain low levels of unemployment are basic to an adequate rate of economic growth. While the level of demand has an important influence on the rate of growth, however, the rate cannot be controlled by merely affecting demand. The rate itself depends on the basic forces affecting such things as productivity, thrift, scientific and technological advance, and enterprise.

There is considerable dispute about the impact of price-level changes on the rate of growth. Some contend that inflation is by itself a stimulus to growth, others argue that inflation is an inevi-

table concomitant of growth, and still others assert that continued inflation will preclude sustained growth. Both general considerations and an examination of the available empirical evidence led the Commission to two conclusions. First, there is no basis for believing that inflation is needed to stimulate growth or that it necessarily accompanies vigorous growth. We see no reason why the country must endure inflation to achieve adequate growth, but we stress once more the role of nondemand measures to make this possible. Second, although every inflation does not lead to a speculative boom which collapses into a major depression, the risk of collapse is sufficiently real that we must strive to avoid the inflation.

In summary, the Commission concludes that all three goals can be achieved simultaneously, and that they are fundamentally compatible if we do not expect the impossible for each, yet some conflicts may arise. Moreover, monetary, credit, and fiscal measures to influence the level of demand are essential ingredients for the attainment of these goals, even though not sufficient by themselves. Both labor and management must cooperate to make our enterprise system work effectively. Other Government measures are required to supplement monetary, credit, and fiscal measures.

Thus far in the committee's deliberations each of the policy instruments has been discussed in isolation. And as was evident from the testimony early this week our very constructive critics have pointed out the limitations which each of the individual policy instruments has. I would hope very much that this piecemeal discussion of the instruments does not lead the members of this committee to conclude that the Commission's report has put all of its eggs in one stabilization basket. The purpose of Chapter IX, "The Choice and Combination of Policy Instruments," is to show how these various policies can be combined, hopefully, to assure that the shortcomings of each is minimized and the strengths of each is maximized in their contribution, first to preventing recessions, second to stopping them once they have started, and at all times to stimulate economic growth.

It is obvious that there is an interrelationship between monetary measures, debt management policies, Government revenue and expenditure policies, and credit policy. The Government can restrain economic activity through tight monetary policies, through budget surpluses and through curtailing Government credit availabilities. Similarly, aggregate demand can be stimulated by an expansionist monetary policy, by Government deficits and by more liberal credit policies.

One of the principal problems involved in the formulation of overall Government economic policy stems from the need to choose which policy instruments should be pursued, alone or in combination with others. In addition, we stress the need for preventive action as well for cures. We include a general discussion of the timing of measures to prevent cumulative deterioration of economic activity while calling attention to the desirability of seeking those actions which are helpful immediately and leave us with minimum stabilization problems for the future.

It would be foolhardy to attempt to formulate in advance the choices and combinations which would fit each and every economic circumstance. Clearly, the performance of our economy varies from

time to time and the characteristics of each boom and each recession are somewhat different. Likewise, timing is highly important and the forces at work affecting the timing of economic changes are seldom identical. Similarly, the reconciliation of various economic goals will necessitate different combinations of policy instruments at different times.

The Commission in chapter IX has attempted to describe the characteristics of each major policy as it relates to timing, the volume or magnitude of the effects it achieves, and its influence on the composition of demand in the economy. Similarly, the implications of various policy measures on balance of payments is discussed. Also, impacts of different policy measures on long-run objectives as compared with stabilization objectives are taken into consideration.

It can be stated without qualification that there was complete agreement among the Commission members that very careful consideration must be given to the subject of policy mix in determining what measures to adopt and how they should be related to each other in the pursuit of low levels of unemployment, vigorous growth, and reasonable price stability. There were, of course, differences with respect to the emphasis to be placed on different policy instruments at different times and under different circumstances.

Coordination is one of the most difficult and delicate of the organizational demands that can be made upon a governmental system as large and as decentralized as ours. It is not to be had for the asking. A useful initial step toward coordination is to unify legislative statements of purpose.

The Commission recommends that the Congress modernize and make consistent the legislative mandates which set out national economic goals in the two statutes that bear most directly on the field of the Commission's concern; namely, the Federal Reserve Act and the Employment Act of 1946. Identical language should be incorporated simultaneously in each to formulate the goals of a low level of unemployment, an adequate rate of economic growth and reasonable price stability as applicable to all Federal agencies administering economic programs.

A second prerequiste of coordination is an organizational focus. Where is central responsibility to be lodged? To this question there can be only one realistic answer for our National Government: in the Presidency, or nowhere.

The Congress has ultimate legislative power across the whole field of economic policy, and all strands in the policy web lead sooner or later through some parts of Congress. But the nature of congressional organization and operation is the dispersion of power, and it would be futile in consequence to seek to center responsibility for coordination of policy in Congress. The search for coordination of economic policy must, as a practical matter, begin in the executive branch, with Congress continuing as a stimulator, critic, and ultimate judge of what will be and will not be given the sanction of legislation.

In its recommendations the Commission tried to build from present strength rather than to leap to innovations, and to try modest advances along both historically traveled routes, which are the Presidential staff approach and the Cabinet-committee approach.

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The Commission felt that the most feasible approach to improving coordination by the Presidental-staff method lay in the strengthening of procedures already laid out in the Employment Act of 1946. The Commission offers three related recommendations to highlight the President's responsibility and to hitch the requirement of an evaluated Presidential report to an occasion that will give it a higher policy significance.

The first recommendation is aimed at improving the quality and timeliness and enhancing the significance of the statistical series relevant to the appraisal of the performance of the economy. The Commission recommends that economic indicators should be issued from the Executive Office of the President.

Placing the responsibility for publication where the responsibility for preparation already lies, coupled with the necessity of meeting White House deadlines for prompt issuance, should be helpful. It should also tend to encourage them to devise additional series and breakdowns so as to make them the best that can be obtained to judge the behavior of the economy in relation to major economic objectives.

Second, the Commission recommends that the Employment Act be amended to provide that whenever in the President's judgment the current economic situation, as revealed over a span of time in the indicators issued from his Executive Office or on the basis of information, shows a tendency significantly counter to the objectives set forth in the Employment Act is amended, and at least quarterly thereafter for so long as the unfavorable tendency prevails, the President shall supplement his annual Economic Report with a statement setting forth:

1. His understanding and assessment of the factors in the economy contributing to the unfavorable tendency.
2. The steps being taken by him and by Government agencies, including the Federal Reserve System, to use existing instruments and resources available for better achieving the goals of the Employment Act as amended.
3. Explanations for any seemingly inconsistent use being made of any of these instruments.
4. Recommendations for any congressional action he thinks advisable.
5. Any other comments he thinks appropriate.

Third, the Commission recommends that the Employment Act be also amended to provide that the Congress may, by concurrent resolution, request the President, if he has not already done so, to furnish such a statement, whenever it finds that the current economic situation reveals a tendency running significantly counter to the objectives set forth in the Employment Act as amended.

The effect of sharpening the President's responsibility should be to strengthen his hand in coordinative moves. And the preparation of his messages will stregthen the staff mechanism of coordination.

But staff assistance in injecting the President's perspective into the deliberations and actions of the various agencies needs supplementation to secure the necessary degree and continuity of consultation. This argues for an effort to make use also of the other types of coordinative mechanism, the Cabinet-committee approach.

The key problem is how to supplement the Presidential-staff approach of the Employment Act procedures so that the two methods could be employed without friction and so as to be mutually reenforcing. The most promising course appears to lie in the revival or creation of something along the lines of the Advisory Board for Economic Growth and Stability.

The Commission concluded that the President will need to make suitable arrangements, congenial to him, for staff and interagency consultative machinery to assist him in discharging his expanded responsibilities. No statutory council should be created which has the effect of constricting his choice of advisers or formalizing their advice. The Commission recommends that he consider setting up an advisory board along the lines of the Advisory Board on Economic Growth and Stability, under a chairman to be designated by him. Its work should be planned so that weekly meetings of department and agency deputies, supported by staff assistance from the Council of Economic Advisers, may culminate in periodic meetings of their chiefs in the presence of the President.

This general framework of coordination, with adaptations to suit particular situations, should apply also to the Government lending agencies. The coverage of the President's reports under the Employment Act should include attention to the actions and policies of the credit agencies. Budget controls apply to most of them in varying degrees. And they should be included in the scope of discussions in the advisory board. No major additional changes in organization seem needed for coordination purposes. It is likely, however, that closer working relationships at operating levels will need to be developed.

A further statutory mechanism of coordination, applicable to the agencies established as Government corporations, may be found in the terms of the Government Corporation Control Act.

The Commission recommends that the Government Corporation Control Act of 1946 be amended so as to direct the Secretary of the Treasury, in the exercise of his clearance power over the issuance and sale of the securities of Government-owned corporations, to take into account explicitly the full range of objectives of the Employment Act as amended, and not merely debt management considerations; and that cases of disagreement be taken to the President. The purpose of this change is to convert the Treasury's apparently absolute policy veto into a flagging device for top-level coordination. It should have the effect not only of broadening the criteria of review but also of bringing the decision, in cases involving substantial policy alternatives, into a presidential forum where the overall economic policy of the Government can be dealt with in a coordinated fashion.

The emergence of the balance-of-payments problem makes a reappraisal of the National Advisory Council on International and Financial Problems (NAC) timely. It is clear that with the passage of time the composition of NAC has become anomalous if it were actually to undertake to fulfill its original coordinating mandate. The Commission recommends that the President should fix a clear and continuing responsibility, perhaps in a subcommittee of the advisory board recommended above, for the direction and coordination of actions required to deal with the balance-of-payments problem,

and, more generally, for the coordination of grant, loan, and trade policies as aspects of American foreign policy. To clear the way for this, the Bretton Woods Agreement Act of 1945 should be amended to enable the President to designate the chairman and membership of the NAC and to assign the responsibility for its staff support. With its statutory base removed, the President would then be free to reconstitute it as an advisory board subcommittee or otherwise relate its work to a more inclusive framework of responsibility.

The Commission stressed agreement on broad objectives and sharpening responsibility in Government if we are to attain our national objectives. The Congress has the responsibility for legislation which will formulate these national objectives and fix the responsibility for carrying forward the necessary measures to make possible a low level of unemployment, reasonable price stability, and adequate economic growth.

In concluding my remarks, I wish to introduce some personal commentary. The great virtue of our democracy is that well meaning people of good will can interpret political forces differently. Freedom of debate and discussion leads to decisions which thus far have preserved our society.

There can be little cause for objection to the Commission's conclusion that there must be unity of purpose within the Government, and the responsibility for leadership and coordination must rest with the President if we are to attain our national objectives. Because of the increased responsibility suggested for the President, we should be alert to maintain the checks and balances which are an essential part of the American philosophy of Government. I would, therefore, make the following suggestions:

The Joint Economic Committee should be furnished with sufficient staff so that it may analyze currently information coming from the Executive Office and the Federal Reserve System as to the state of the economy and the extent to which current trends are running contary to the goals of a low level of unemployment, a satisfactory rate of economic growth, and reasonable price stability.

Congress, which must provide the necessary legislative authority, is equally concerned with the President as to these matters.

The Federal Reserve System, while a part of Government, can and should be the qualified, professional, nonpolitical agency with particular responsibility for monetary and credit policies.

The President should, in the proposed supplementary economic report, indicate the specific actions being taken by the Federal Reserve System and the reasons therefor in order that Congress and the citizens may have the benefit of the Federal Reserve System's independent judgment.

FEDERAL RESERVE INDEPENDENCE WITHIN THE GOVERNMENT

The crux of the problem of the Federal Reserve's being part of the Government, and yet having independence and integrity in making important decisions as to economic stability, lies, in my opinion, in a better understanding on the part of Government officials, Congress, leaders in business and banking, and citizens generally concerning the basis on which the Federal Reserve acts, specific actions taken, and the results achieved in furthering stability in the economy. Only by encouraging such an understanding, based on intelligent appraisal over a period of time, can the Federal Reserve meet its responsibilities.

FEDERAL RESERVE OPEN MARKET OPERATIONS

After reflection, I feel that the Commission was wrong in its recommendations as to changes in the Open Market Committee. I believe that a continuance of the present arrangement under which the best qualified individuals in the System would comprise the Open Market Committee, is essential to provide the necessary efficiency in dealing with this most important matter.

PRESIDENT'S LIMITED DISCRETIONARY AUTHORITY FOR TAX REDUCTION

The most novel and controversial recommendation in the report is the one dealing with an increase or decrease of five percentage points in the first bracket income tax rate for the purpose of aiding economic stability. This recommendation and its companion suggestion as to an automatic change in the first bracket rate of the personal income tax, in response to changes in appropriate economic indicators, drew the largest number of footnotes of any Commission recommendation. You will recall that the President, according to the Commission's recommendation, would be reporting to Congress about the status of the economy at appropriate times; that his office would be providing the primary source of Government information regarding the economy through Economic Indicators; and that the Commission recommended—

> that Congress grant to the President limited conditional power to make temporary countercyclical adjustments in the first bracket rate of the personal income tax, the grant to be accompanied by certain safeguards, including Congress' right of veto.

The difficulty encountered by the Federal Reserve Board in obtaining acceptance of effective restrictive measures in the midst of a boom is evidence to me that no President under the specified conditions is going to recommend that Congress increase taxes to offset a boom. It, therefore, seems to me that the effect of the Commission's recommendation will be to give the President the mandate, regardless of whether a tax reduction is the best or only remedy that might be used, to force a reduction in the first bracket income tax rate with funds provided through deficit financing, which would add to the possibility of inflation.

The mandate weakens the desirable system of checks and balances between the executive and legislative departments. The recommendation also weakens the independence of the Federal Reserve Board through the implied threat of a presidentially forced tax reduction in case the Board and the President do not agree on the adequacy of the measures being taken. Using tax education methods as a means of offsetting a downward trend in the economy requires not only statistical information but experience and judgment. Hearings before Congress would be highly desirable. Consideration should be given to the precedent being set, possible overemphasis on aggregate demand as compared with other causes of economic adjustment, and a possible deterioration of citizens' and business' confidence. This could materially influence essential acceleration of capital expenditures. For these reasons, I and others opposed this recommendation and believe it should definitely be eliminated. In opposing this particular recom-

mendation, I am not stating that a reduction in the first-bracket income tax rate for a limited time may not be, under certain conditions, an appropriate remedy to aid in reversing adverse economic conditions. When made, it certainly should have, in addition to the President's recommendation, the benefit of the experience and judgment of the Federal Reserve System and the determination by Congress that a tax reduction is the most effective and soundest method to meet the particular situation.

I wish you all success in meeting your responsibilities in a manner that will insure the confidence and cooperation, not only of Government, but of all citizens.

Chairman PATMAN. Thank you, Mr. Thomson.

We have another witness, but we must interrogate Mr. Thomson, of course, keeping in mind that we have meetings of the House and Senate.

We will just take some time to interrogate Mr. Thomson anyway, and then we must hear Mr. Sonne. He is the Vice Chairman of this important Commission, and we will probably want to ask him some questions. Mr. Curtis?

Representative CURTIS. The one thing I have in mind is something that I have asked other witnesses, Mr. Thomson, and it is in relation to the debt, the Federal debt, which underlines a great deal of our monetary policy.

The question that remains really undiscussed is: Should we have a Federal debt at all—I mean we are talking now of ultimate objectives—and certainly, if we had no Federal debt, a great deal of the monetary policies that the Federal Government does exercise would be considerably limited.

If we were to answer and say "Yes," from a practical standpoint, whether we like it or not we have got a big Federal debt, and probably in theory there always would be a debt, then comes the question of what should its size be, or is there any limit.

If we are to limit it, what guidelines do we use?

Is it a percentage of gross national product, or is the very aggregate size in relation to the management of it the important problem to consider?

All of this, in my judgment, relates to taxation policies, of course, because they, in turn, have related to deficit financing or a balanced budget approach.

It has been very difficult for me to follow the report of the Commission on Money and Credit without some basic discussion of these factors. I wonder if you would comment on that.

Mr. THOMSON. First, I would assume that the question of debt management was discussed when that was before your committee this week, was it not?

Representative CURTIS. That is right.

Mr. THOMSON. Do not misunderstand me. I do not want to go into the details of debt management. I am trying to get the broad relationships. Tax reduction, in my judgment, always has to be related to the Federal debt, because we can either use tax money to pay off the Federal debt or we could use it for more expenditures.

When we discuss deficit financing, it is a question of whether we are going to finance through taxes or through selling more bonds.

And when we discuss monetary policy, it, in turn, may affect the amount of Federal bonds that need to be marketed.

Representative CURTIS. And that has a direct impact on our monetary policy. Whatever we might wish, the flames of inflation, to a large degree, are fed by the size of the Federal debt. I do not want to get into the details of the polices involved in debt management, but I am trying to relate this fundamental concept to these other policies, and I do not find a basic discussion.

Let me ask the question this way: Do you feel that we should always have a Federal debt?

Mr. THOMSON. I think, as far as anybody can see, you are going to have a Federal debt for some time to come, because the alternative, unless you had a tremendous prosperity, would mean that by a definite debt reduction policy over a short time, you would be hampering the economy to the extent that I do not believe Congress would approve.

I think you would have to stop and think, when you talk about the debt and the fact that the debt has unfortunate consequences to the Government, as well as to individuals, that the largest part of the debt came from war.

Representative CURTIS. That is true.

Mr. THOMSON. Then you have to think in terms of a policy that will control expenditures by Government. I think over the years that most people who have studied this question have come to the conclusion that you have to have a budget-balancing principle and that Congress has to keep that very definitely in mind so that the debt does not get out of proportion.

Representative CURTIS. That is what we are getting, out of proportion.

What do we mean?

Let me interject again to try to get this in context. There are many people who, in theory, argue that there should be no debt. I even wonder about the theory. How would we handle—here is another way of posing the question—how would we handle monetary policy if there were no Federal debt, if we did not have the Government bonds that we market?

So is the theory correct? I agree with you, from a practical standpoint, that in the foreseeable future, regardless of theory, we are going to have a debt.

But I do think it makes a difference if our theory would be to ultimately eliminate the debt. Now, I understand Great Britain has the consol concept of the Government bond that has no maturity. We have never used consol.

Apparently, a consol can be in the British system because their theory must be that they will always have a debt. Our theory has never been that.

Maybe it should be, but there are many people who keep saying, if we could, we should not have any debt.

I do not know, but I would have thought such a fundamental matter would come in for discussion.

And then the second thing is what you are addressing your attention to, and I stopped you in your answer, or what should the size be. And certainly, in discussing monetary and fiscal policy in the year 1961, we

must relate it to the fact that the Federal debt is certain percentage points of the GNP, is of this size, and the management of that debt has a great impact on both fiscal and monetary policies.

Mr. THOMSON. I think you have to start with the recognition that the debt, of itself, and the instruments that make up the debt, do serve a purpose in our economy, and, as you said, that you would have to probably replace those in some other way, if you did not have the Government debt.

It seems to me that you have to approach that thing from the general question that there must be some control of expenditures.

An increase in the debt that is not justified through Congress and in the minds of the citizens and that creates the impression that you are going inflationwise and that you are spending, regardless, is a bad thing.

I do not think you can define it in definite terms in relation to GNP or on any statistical basis. So I come to the question of your budgetary policy, and this report makes the suggestion that budgetary policy should be improved so as to not only take into account the cash budget and the ordinary budget, but budget procedures that will indicate the effect of congressional policies as to expenditures and as to the measures you are taking, so that you can have a better opportunity to judge the measurement taken in relation to the debt.

Now, the report also says that the ceiling on the debt should be eliminated, and maybe that sounds a little contrary to the idea of controlling the amount of debt.

Representative CURTIS. No; because the ceiling on the debt is really not a ceiling on the debt at all. It just relates to marketing Federal bonds.

Mr. THOMSON. That is right.

Representative CURTIS. The debt is there.

Mr. THOMSON. That is right.

Representative CURTIS. We have created the expenditures, the obligations. It is just a question of how we are going to pay for them.

Mr. THOMSON. I would say that prudent housekeeping in Government is just as important as it is in the private economy, and that the question you raise, granting the existence of the present debt, granting that it serves a purpose, and that to try and reduce it quickly, through a debt reduction policy, would seriously interfere with the economy, your question comes back to the question of how Congress is going to control the budget so that you have a sound control of expenditures, and that those are related to sound considerations as to the public good.

Representative CURTIS. Mr. Thomson, I will put it this way, and I think my time is up. In the Ways and Means Committee we have, of course, the job of trying to figure out the taxes. If we do not raise enough taxes, then the same committee has to consider how we are going to market the Federal debt, and we know that whenever there is a gap, it is not that we are going to get out of paying.

We have to pay it.

It is a question of whether we will pay for those expenditures through increased taxes or through deficit financing, which, in turn, is just selling more Government bonds.

So we are faced with this problem constantly, and yet, I have never heard a discussion or read a discussion on any economic guidelines that we should be considering as to whether we will finance this project by increasing tax revenues or by floating more bonds.

Yet that underlies any discussion, must underlie any discussion of using fiscal policy, tax policy, to affect economic results.

Again, I think that we in Ways and Means, whether we like it or not, by making that decision have a tremendous impact on monetary policy which then goes over to Congressman Patman's Committee on Banking and Currency.

There has been practically no coordination, I can assure you, between the two committees or their staffs. And the same coordination would have to come through the Joint Economic Committee if these other legislative committees were to listen to what we might say.

Mr. THOMSON. One thing, it seems to me, that you must get out of this whole discussion is that there is not any one thing that will do the trick; that you have got to take the whole problem together. And the main reliance, I think, should be placed on the private system, how you get the private system to do the most in order that it can support Government and do the things you want to do for the people.

In this report of ours, the one thing that I think we did not touch on, and I think it is only one thing that we did not touch on in our field, is the question of the tax reform. But we did say you had to give consideration to the tax reform and you had to relate that to incentives that will enable you to have this high level of economy.

The main thing I am trying to get is that you get first your emphasis on a private economy and what Government does to stimulate that, which is the kind of taxes you get and whether you do balance your budget, except in the case of war.

These matters are materially affected by Congress determination as to what the social objectives are.

The whole thing has to be taken together.

And I think in your committee and the other committees that deal with that, if you develop a prospective on this whole problem, you will have rendered the country a great service.

Chairman PATMAN. I would like to comment briefly on this national debt.

The way I look at it, our capitalistic system, which is the finest and best system in the world, is based on debt. No debt, no money; you agree with that, do you not, Mr Thomson?

Mr. THOMSON. Yes.

Chairman PATMAN. Outside of the minor coins, the Lincoln "greenbacks," and a small amount of money like that, that is all that would be left.

If everybody paid their debts, there would be no money. Is there any question about that?

Representative CURTIS. There might be a question in semantics.

Senator SPARKMAN. I just would add a comment. You were naming the different currencies; I would add, "and a little counterfeit."

Chairman PATMAN. That is right. Therefore, this country could have developed much faster and progressed a lot more, if preceding

World War I, our national debt had been much higher, because we would have had more money with which to do business.

But we were retarded in that case by a lack of debt. But now then we have a huge debt, $290 billion. The question is: Should we reduce it?

Yes, of course, we should reduce it as private business wants to borrow more, because somebody has got to go into debt to have money.

Therefore, a huge national debt is a deterrent to progress, the way I see it. It is a barrier to the private enterprise system in a way, because, when our debt is so large that if people in private business want to go into debt, they say, "Oh, no, you can't do that because that will cause inflation," and probably it will; therefore, we should always be on the alert, I think, to reduce the debt as quickly and as rapidly as possible.

That is the reason I would like to see Congress not adjourn a session until arrangements are made to balance the budget, and then pay, when times are good, to pay a sizable amount on the national debt, because I think we should get rid of it as fast as we can and encourage other people to go into debt. We have got to encourage them—"encourage" is not the right word—but to permit them to do it.

Mr. THOMSON. I think that is a theoretical viewpoint, but I think that you come around to realize that you want the budget to be balanced according to certain conditions.

Chairman PATMAN. When times are good, pay something on the national debt and balance the budget?

Mr. THOMSON. But that does not mean you are going to reduce it, though.

Chairman PATMAN. If you pay something on the national debt, you would reduce it. Are there any other questions?

Thank you very much, Mr. Thomson. And I will submit some questions in writing.

Mr. THOMSON. I sincerely wish you good luck.

Chairman PATMAN. Thank you very much.

QUESTIONS OF CHAIRMAN PATMAN FOR MR. THOMPSON AND REPLIES THERETO

Question 1. I was particularly interested in your statement that Congress should give full consideration to the necessity for preserving and strengthening workable competition.

Did the Commission make any recommendations as to how we could strengthen the competition?

Answer: On page 6 of the Commission's report we stated that the Commission's investigation led necessarily beyond the narrow area of money and credit because many policies and measures in addition to monetary and credit measures bear on the national economic objectives which were the center of the Commission's concern. The Commission has commented on other measures and has shown their relationship to monetary and credit policy measures, but in general recommendations have been confined to the area of money and credit.

In consequence we made no specific recommendations on how to strengthen competition in product markets generally, except that we called attention (on p. 40) to the desirability of a continued vigorous antitrust policy to encourage competition and to encourage greater price flexibility. We also have commented on the desirability of a low tariff policy and a minimum of quotas in order to obtain the benefits from foreign competition.

I should mention also that a substantial part of chapter VI of the Commission's report deals with measures to increase the effectiveness of competition among private financial institutions. I assume, however, that your question is aimed primarily at product markets generally.

Question 2. You make an important case, it seems to me, to the fact that monopolistic control on market power is the real problem behind the tendency to inflation; and I would agree with you that it is very difficult for Government action, whether it be monetary policies or budget deficits, to counteract the results of this market power.

Did the Commission make any recommendation as to any direct action the Government should take concerning prices and wages?

Answer. Again the Commission did not make specific recommendations as to direct action by the Government in the area of wages and prices. We did call attention to the desirability of increasing the effectiveness of labor markets by having the Government provide better information for matching men and jobs through an improved employment service, eliminating discrimination against particular groups of workers, providing retraining opportunities for workers displaced by technical change, and helping to move workers out of, or industry into, depressed areas. Such measures would improve labor mobility and reduced localized shortages at a given level of employment. This in turn would lessen inflationary pressures from wages.

Question 3. On page 8, Mr. Thompson, you say coordination is one of the most difficult and delicate of the organiaztional demands that can be made upon the governmental system.

Then you add that the Commission recommends that Congress aid price stability to the Employment Act of 1946 and also write this act into the Federal Reserve Act.

Do you really feel that writing these general statements of our economic goals into the Federal Reserve Act will somehow bring about better coordination between the Federal Reserve and the rest of the Government?

Or let me put it this way: Do you feel that the Federal Reserve now does not accept the Employment Act of 1946 as the prevailing law which applies to the Federal Reserve System?

Answer 3. On page 263 of the Commission's report we recommend unifying the mandates set forth in the Employment Act and the Federal Reserve Act. We recognize that a formula of words, even enacted into law, will not by itself guarantee unity of purpose among those who are charged to give it effect. But its absence is an invitation to misunderstanding and disagreement, for the publicly avowed purposes of Government agencies are expressed in their separate organic statutes. A useful initial step toward coordination is therefore to unify legislative statements of purpose.

We were quite aware of the statements made on several occasions by the Chairman of the Board of Governors of the Federal Reserve System that the goals of the Employment Act applied to the Federal Reserve as they did to all agencies of the Federal Government. It was our feeling, however, that the wording of the statement of purpose of the Employment Act is not completely explicit in formulating the goal not only of a low level unemployment but also of an adequate rate of economic growth and of reasonable price stability. It was our feeling that if the statement for these three goals could be made explicit in a way so as to call for their simultaneous achievement that all agencies would give the three goals equal priority.

Question 4. Did the Commission give any consideration to the question of putting control over taxes and spending policies in an independent agency?

Answer 4. At no time did the Commission give consideration to the question of putting control of taxes and spending policies in an independent agency. We felt strongly that these were matters which have been and are the fundamental responsibility of the Congress. In the one recommendation of the Commission to grant to the President limited conditional power to make temporary countercyclical adjustments in the first bracket rate of the personal income tax we emphasized that the grant was conditional and was made subject to a legislative veto by a concurrent resolution of both Houses of Congress before the tax adjustment could take effect. In addition, the grant of such conditional power to the President would require full consideration by the Congress.

Question 5. In your statement you say that the Commission examined available and empirical evidence on the question whether inflation is:

(*a*) A stimulus to growth;

(*b*) Inflation is the result of growth; and

(*c*) Inflation is an obstacle to substained growth.

I wonder if you could make available for the committee for inclusion in the hearing record, if the evidence is not too lengthy, the empirical evidence on these questions?

Answer 5. I include a section of a staff paper prepared for the Commission which summarizes some of the evidence on the relation between prices and economic growth:

PRICE STABILITY AND ECONOMIC GROWTH

Until recently it has been widely assumed that inflation encourages growth. Earl Hamilton has presented historical studies which lead him to the conclusion that the industrial revolution in Western Europe was greatly stimulated by the rising prices that resulted from the great influx of gold from the New World. Many economists regard inflation as an effective way to promote growth in underdeveloped countries.

In contrast to this traditional view there is today a widespread and powerful reaction from both businessmen and economists. This group not only reject the view that inflation is an effective means to achieve growth; they generally argue that it is a positive deterrent to growth.

These conflicting views will be briefly summarized and, so far as possible, tested by reference to experience.

1 The view that inflation supports growth

The following arguments have been advanced to support the conclusion that inflation is good for growth, or is a necessary concommitant of it. (1) Inflation benefits the rich at the expense of the poor, and it thereby encourages saving, since the rich save more than the poor. This saving provides funds for the construction of capital goods, for research, and for other growth activities. Furthermore, the high profits generated by inflation provide "inside funds" available for business expansion without the need to go to the market and borrow. (2) The high profits just mentioned also encourage business to expand plant and equipment in the expectation that these conditions will continue. Thus business will employ the saved funds made available according to the first argument. (3) Even aside from actual increases in profits, under present accounting methods inflation leads to underestimates of depreciation, hence giving the spurious appearance of greater real profits than in fact exist. This, as well as actual profit increases, encourages investment expansion.

The two remaining arguments are of a somewhat different nature. According to the first, (4) even if inflation is not itself a direct stimulant to growth, it may turn out to be a necessary consequence of growth policies. For example, under present conditions, with wages and prices inflexible downward and with other factors leading to market-power inflation, it may be impossible to maintain the high level employment required for growth without causing inflation at the same time. The second argument (5) holds that inflation may provide part of the means by which "forced saving" can stimulate growth. If a government prints new money and spends these funds on growth activities it can thereby increase the proportion of total output going to expansion, since this process increases the portion of total spending power in the hands of those who wish to spend for growth in contrast to those who would use it for current consumption. In this case effective saving is imposed upon the community by the fact that prices rise faster than money income, making it impossible for households to buy as much as before. The resulting "saving" of the economy taken as a whole is often called forced saving.

2. The view that inflation impedes growth

Those who believe that inflation impedes growth give reasons to reject most or all of the preceding arguments, but they also add the following to support their own conclusions: (1) Savings is not encouraged by inflation, but quite the contrary. People soon learn that the value of their money, their bonds, their life insurance, and their savings accounts will continually decline over time because of rising prices. They therefore spend promptly in order to get full value for their dollar. (2) To the extent that saving is continued, much of it may go to nonproductive or foreign activities. These include land speculation, jewelry hoards, and foreign investment. (3) Inflation causes uncertainty regarding the future, thereby discouraging business expansion. (4) Rising prices stimulate the growth of devices to protect individuals and groups against their ravages. Unions press more strongly for wage increases, business tries to raise prices enough to cover not only past but also prospective increases in costs, farmers press for higher support prices for their crops, many varieties of escalation are attempted. One result is social strife, with the possible loss of production from strikes or slowdowns. (5) Inefficiency is encouraged on the

part of both labor and management. Workers are sure of jobs and are not pressed to perform well. Management is not afraid of increased costs, either from rising wages or from lowered efficiency, since it is confident that these can be pushed on to the consumer through higher prices. Growth and saving are both reduced by inefficiency.

3. Evaluation of the controversy

In evaluating the arguments on both sides of this controversy it may first be noted that all of them bear upon the consequences of rising prices on "effective" or "realized" saving. This is logical, since growth takes place through the use of income that is not "consumed" but used instead to expand plant and equipment, or to educate and train workers, or to carry on research in new methods of production.

A number of methods may be used to test the arguments presented here. One is to consider the behavior of two types of decision that interact to determine the amount of saving that will in fact take place. An oversimplified statement may be used to illustrate these two crucial decisions. If we imagine ourselves beginning with stable prices and full employment, we may ask what major decisions would be required to increase effective saving. The answer is that consumers would have to decide to spend less on consumption, thereby making funds available for expenditure on growth activities; and enterprise or government must decide to build the plant and equipment, or employ the researchers, made possible by the use of these funds. If only the first of these decisions is made, then the result will be unemployment, lower income, and probably no increase in effective saving. If only the latter of the two decisions is made the result will be inflation, with consumers trying to buy as much as before and business trying to buy more, while total output remains unchanged. Only if both decisions are made together will realized saving be expanded without inflation.

a. The desire to save.—This analysis of the determinants of effective saving is incomplete, but it suggests a way to begin evaluation of the conflicting views described above. The first argument on both sides concerns the decisions of households whether to try to save. For a number of reasons, the stronger position here is the one given by those who fear the consequences of inflation, though even their stand is less compelling than it may at first appear. The proinflationist view that saving is encouraged by rising prices because inflation redistributes income from poor to rich has been implicitly discussed in the section on the consequences of inflation on the distribution of income. It has been found untenable under present circumstances, because the postulated redistribution does not necessarily take place. Furthermore, even the longrun historical studies of Hamilton have been criticized on the ground that available statistics show no redistribution of income away from wages during the period of the industrial revolution. We must conclude that there is no firm basis for the view that inflation will, in general, encourage planned saving. On the other hand, the view that rising prices will reduce planned saving is usually oversimplified and thereby overstated. Saving may take many forms, not just that of investment in fixed-price assets. To an important extent the effects of inflation may be to change the form of desired saving rather than the amount. This view is supported by the discussion above regarding consumer expectations and spending, as well as by Scitovsky's view regarding foreign experience under more serious and prolonged inflation.

b. The desire to expand capital goods.—We turn now to the effect of inflation on the desire to buy capital goods or to invest in other types of growth activities. The second and third arguments of those who believe inflation stimulates growth are based on the view that rising prices increase profit expectations, partly because further inflation would in fact raise profits and partly because they will raise spurious hopes of such profit increases. The first of these arguments, like that with respect to desired saving, falls to the ground when it is recognized that, as argued above, "real" business profits are not uniformly or at all consistently increased by inflation. Money profits are, of course, increased in most cases, but not, in general, by more than the price rise. The second argument is weak for two reasons. In the first place it is unlikely that business will be long deceived regarding its true profits by inadequate accounting methods. In the second place, any expansion that resulted from spurious hopes would represent misallocations and would normally lead to subsequent reversal or bankruptcy, which hardly provides a solid base for economic growth.

4. Empirical evidence on saving and inflation

Consideration of the complex elements entering the saving and investment decisions in our economy suggest that it is virtually impossible by a priori reasoning alone to arrive at firm views on the effects of inflation on effective saving and hence on this determinant of growth. It is useful, therefore, to examine the historical record of these relationships.

First, we present in chart III[1] the relationship between personal saving and price movements in the United States by selected years since 1910. Since the major determinant regarding saving is income, however, it would be quite misleading to relate aggregate saving directly to price changes, without reference to this major influence. Our method of correcting for the effects of income on saving is to show on the vertical axis, not aggregate savings, but the ratio of personal saving to disposable income. On the horizontal axis we show the annual percentage change in price. The numbers represent the year of the observation. For example, the 0.47 implies that in 1947 personal saving was 3 percent of disposable income, and prices during the preceding year rose 11½ percent. The years of the depression and the war are omitted because in both instances it seems reasonably clear that the behavior of prices and personal saving were overwhelmingly determined by other elements, and that their relationship to each other was coincidental. This scatter of points exhibits virtually no shape whatever, implying that there is no observably systematic influence of price increases upon personal saving, at least when price movements are not greater than in the United States during these years.[2]

These observations are not conclusive. Many variables are always at work and the effects of rising prices upon saving and investment may at all times be swamped by these other forces. The observations do seem significant nonetheless. If the impact of mildly rising prices were a truly important stimulus to saving, or a serious impediment. that fact ought to show up through some such study as those we and others have made. At present we shall have to conclude that neither side of the argument at this point has a demonstrably superior case on the basis of either logic or history.

5. Inflation and growth: Other considerations

We believe that with some qualifications there is truth in each of the remaining arguments presented on both sides of the controversy. On the one hand, the evidence of history seems to support the view that "forced saving" through inflation has been and can be a device for stimulating growth. It has been effective in Mexico, though not intentionally imposed. It has achieved this end in Brazil although at a terrible cost. It has probably played a role in many underdeveloped countries. But when it is pushed too far it can become extremely dangerous and it is very likely to place the burden of growth on the backs of workers. Likewise, it seems entirely possible that if we do not take effective actions to prevent

[1] There is a chart II, but no chart I.

[2] The data for all years, including war and depression are plotted in chart II for those interested. The scatter shows a clear pattern which would imply that effective savings is actively encouraged by inflation. We believe that this interpretation would be spurious for the reasons cited above. In case it may be suggested that we have chosen the wrong timelag for these scatters, time series are presented in chart IV. Our study of the series did not suggest any way to derive a legitimate correlation by changing the lag. Scatters relating the ratio of gross private investment and GNP to price changes were equally unrevealing of any systematic relationship between these variables.

administered price inflation (including prices administered by government), it may be that monetary policy intended to achieved maximum growth may simultaneously force some rising prices upon us. Turning to the other side, there seems to be little question that inflation tends to generate the forces that perpetuate itself by encouraging organized groups to struggle by nonmarket methods, each attempting to increase its share of the pie. And inefficiences both on the part of labor and management are often associated with inflationary movements though these probably result more from overfull employment than from rising prices.

Once again it seems difficult by a priori argument to weigh these considerations against one another, and once again it is useful to try to observe whether the historical record can help to provide a solution. In these cases we have compared price movements directly with economic growth.

One study is summarized in chart V by a scatter diagram comparing average rates of per capita growth with average price changes in over-lapping decades going back to, or even into, the 19th century for six countries: the United States, Germany, Japan, United Kingdom, Netherlands, and Italy. The scatter offers very little evidence of a relation between rates of growth and rates of price changes. If there is any indication at all it is that rates of price increase from 0 to 6 percent per year are more favorable to growth than either price declines or rates of inflation greater than this. Within this range there were only two cases of "negative growth"; beyond it there were quite a few. Yet it is striking to note that there are large numbers of cases of substantial growth associated both with falling prices and with quite rapid inflation.

Chart VI is based on more recent experience, showing annual average rates of change in real GNP against rates of change in prices for 29 different countries. The years included are generally from about 1948 to 1958, but the coverage differs somewhat between countries because of data problems. It is clear in this case that three of the four countries suffering the most extreme inflation (Argentina, Bolivia, and Chile) recorded growth records among the worst of any shown. It must be recognized that Brazil, Turkey, Greece, and Mexico record substantial growth performances despite price increases ranging from 7 to 15 percent per year, but in each instance except that of Mexico the recorded growth is overstated or combined with substantial economic dislocations. In Greece and Turkey, moreover foreign aid provided an important basis for the growth.

It is obvious that simple comparisons of data like these can be only suggestive. It is necessary to know much more about the reasons for achievements in each case before generalizations can safely be made. But one should surely except that even scatters like these ought to show some correlation if there is a systematic effect of moderate price increases upon rates of growth. Certainly it is fully established by these data that growth can take place in widely varying environments with respect to price behavior.

Times series are for some purposes more revealing than scatter diagrams, and charts VII to IX are provided for those who wish to see this construction of the data. These graphs, of course, suggest the same mixed relations between output and price changes as are revealed by the scatter diagrams. Longrun movements are shown in chart VII for six countries. The following observations are among those that may be noted. The most sustained and rapid increases of output appeared in Japan and the United States. In the former, this

economic growth was associated with an equally rapid rise in general prices except for the period from the midtwenties to the early thirties, when rapidly declining prices seem to have had no obvious effect on the growth of output. The war period of the forties, however, brought skyrocketing prices and a sharp decline in output. Turning to the United States, a rate of growth that was only slightly less marked than Japan's was associated first with a substantial period of slowly declining prices, then with equally slowly rising prices. Prices and output moved down together in the great depression, but causation was dominated by other factors. In the United Kingdom it would appear that maximum growth rates were associated with declining prices, but a strong upward movement of output data following the midthirties does not seem to have been impeded by fairly rapid price increases. On the other hand, the pressures of the First World War resulted in sharp inflationary movements in both the United Kingdom and Italy, and each was associated with retardation of expansion in output.

The data of chart VII can show only longrun movements, since each point represents a 10-year average. Postwar data shown in charts VIII and IX show annual changes and cover more countries. Once again, however, the results tell the same story: there is revealed no systematic relation between moderate price movements and per capita economic growth. Japan's rapid rate of growth from 1950 onward looks very much the same during the period of rapidly rising prices to 1954 as it does in the subsequent period of striking price stability. The rate of price increase in Germany was very similar to our own, but her rate of growth far exceeded ours. Norway's growth rate seems to have been little affected by the marked slowing down of price rise that occurred in 1952.

6. Summary

In view of all these considerations, we may briefly summarize our position as follows:

It has long been presumed by many writers that inflation tends to encourage economic growth. Recently an abundance of literature has presented an exactly opposite view, holding that inflation is a major enomy of growth. In evaluating these conflicting views, we have considered the individual arguments presented in support of each position, and we have also looked at the historical record. Our conclusion is as follows. First, there is no reason to expect inflation, per se, to increase economic growth. There may be some policies, however, which result in both inflation and economic growth simultaneously. Among the examples that might be given of countries employing such policies, though with entirely different methods and results, are Mexico and Brazil. In the former, inflation and "forced saving" were not conscious policy, and serious efforts to hold them in check have been made since 1955, but the fact remains that substantial price increases have not prevented buoyant growth. In Brazil the statistics surely overstate the growth record, which has been very strong in some sectors and extremely bad in others. But there is little room for doubt that substantial growth has been realized, and that this was achieved partly by "forced saving." The history of simultaneous growth and rising general prices in a number of countries like these does not contradict the fact that inflation and overfull employment often cause inefficiencies, social strife, and economic waste, all of which interfere with economic growth. It seems probable that Brazil might have achieved more rapid growth with less rapid inflation if

she had followed other policies, and the Mexican Government found it desirable to bridle its rapidly rising prices.

As a result of the mixed effect of inflationary practices it is not surprising to find that economic growth has been associated with a wide variety of price experience. Longrun studies of six major countries show somewhat better growth records when overlapping decade averages of price increases are less than 6 percent per year than when they are more rapid or when prices have declined (charts V and VII). But there are many cases where excellent growth records were associated with much more rapid inflation than 6 percent per year, or with price declines. Postwar studies of 29 countries offer a somewhat similar conclusion (charts VI and VIII–IX). Three out of the four countries with extreme rates of price increase (above 15 percent per year) have very poor growth records. Aside from these extreme cases, however, the evidence permits no clear generalization regarding the influence of general price movements on growth.

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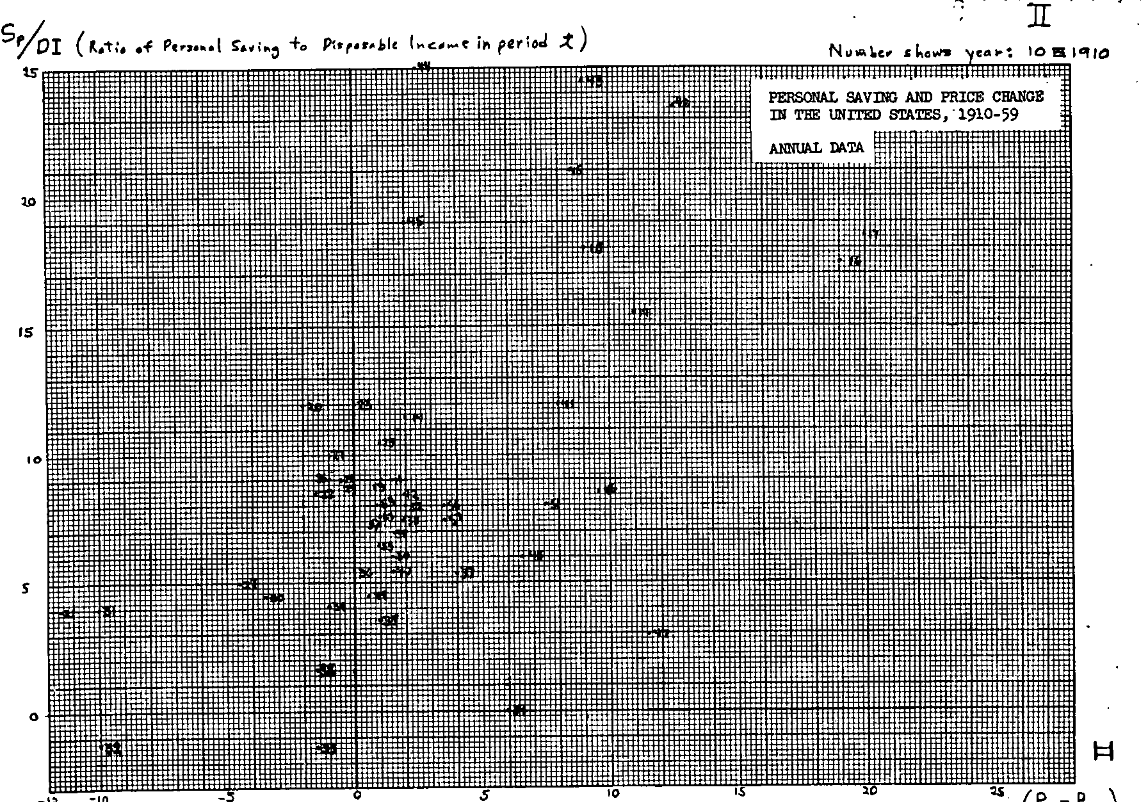
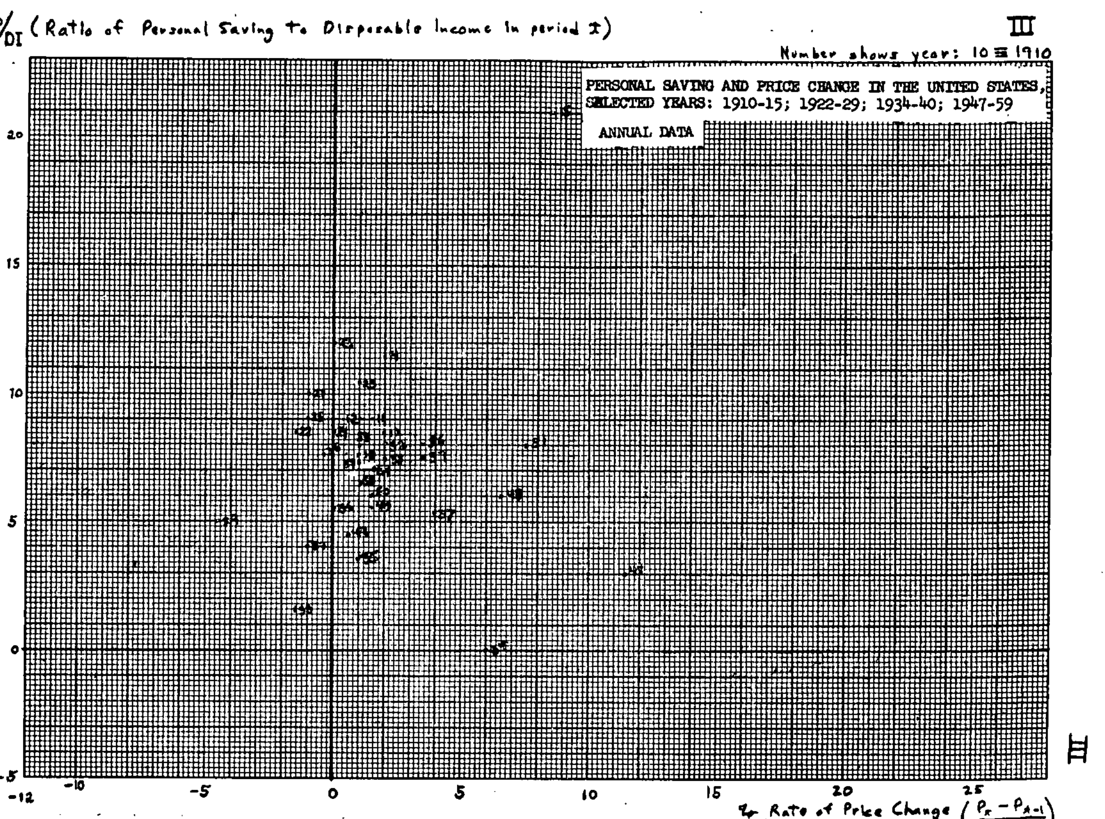
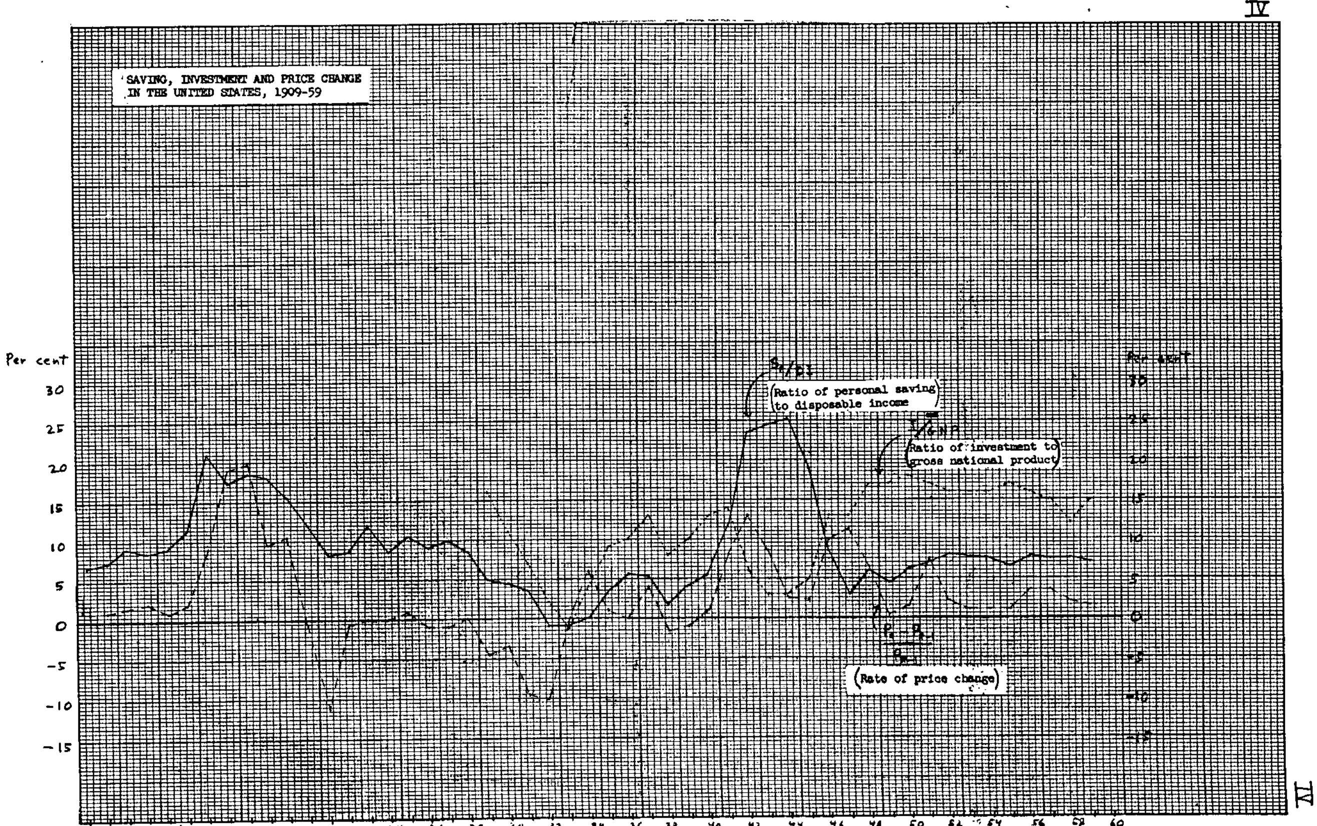


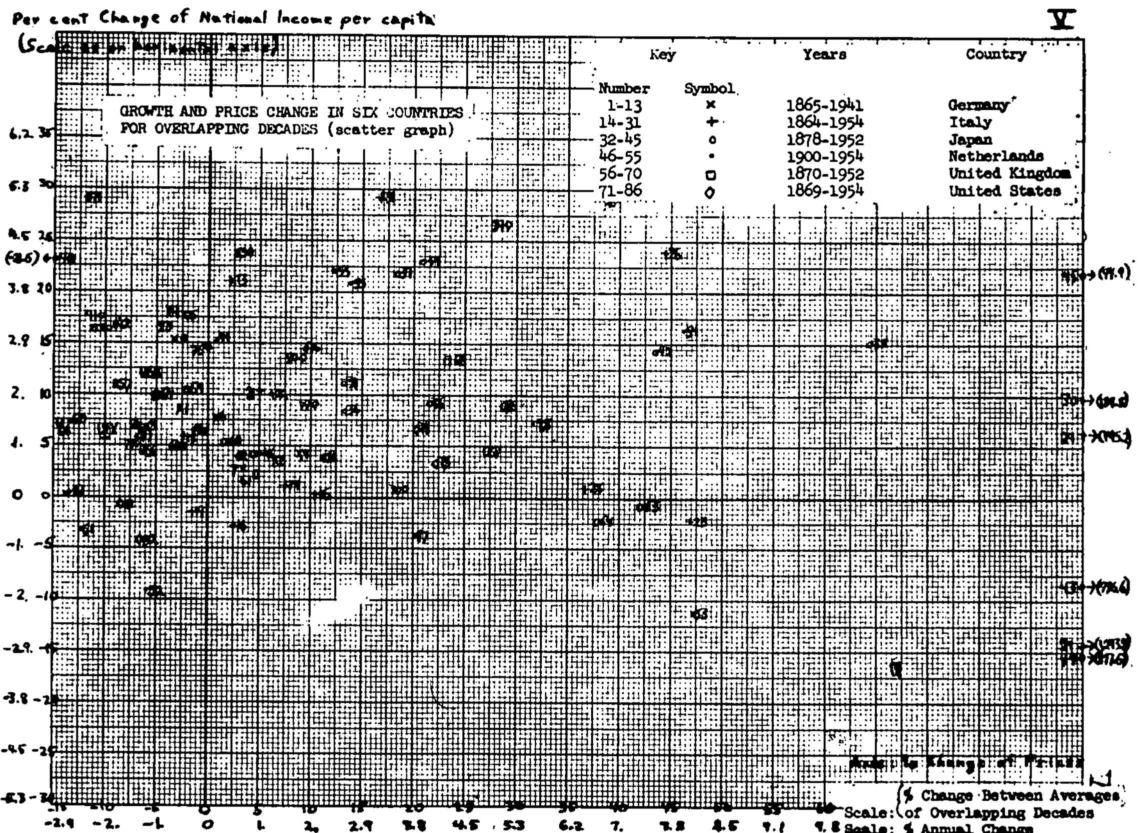
II
Sp/DI (Ratio of Personal Saving to Disposable Income in period t)
Number shows year: 10 ≡ 1910
PERSONAL SAVING AND PRICE CHANGE
IN THE UNITED STATES, 1910-59
ANNUAL DATA
25
20
15
10
5
0
-12
-10
-5
0
5
10
15
20
25
% Rate of Price Change $\left(\frac{P_t - P_{t-1}}{P_{t-1}}\right)$
II

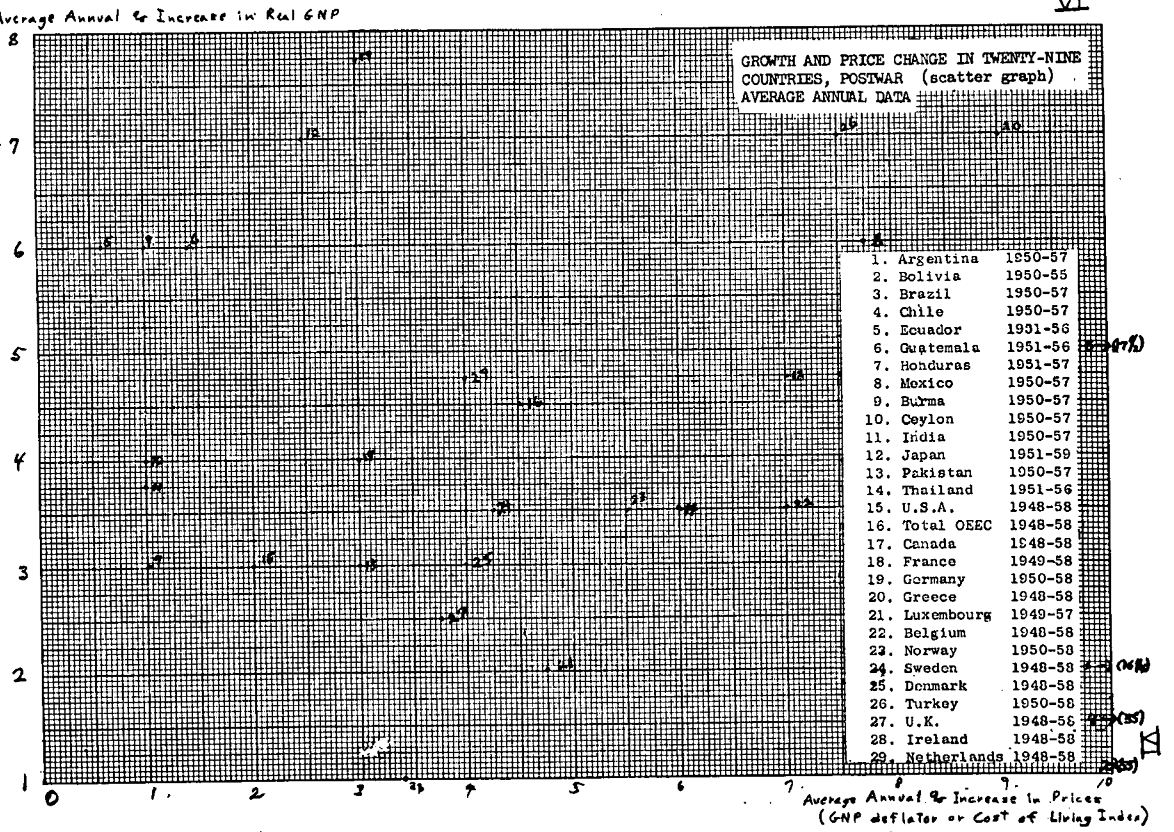


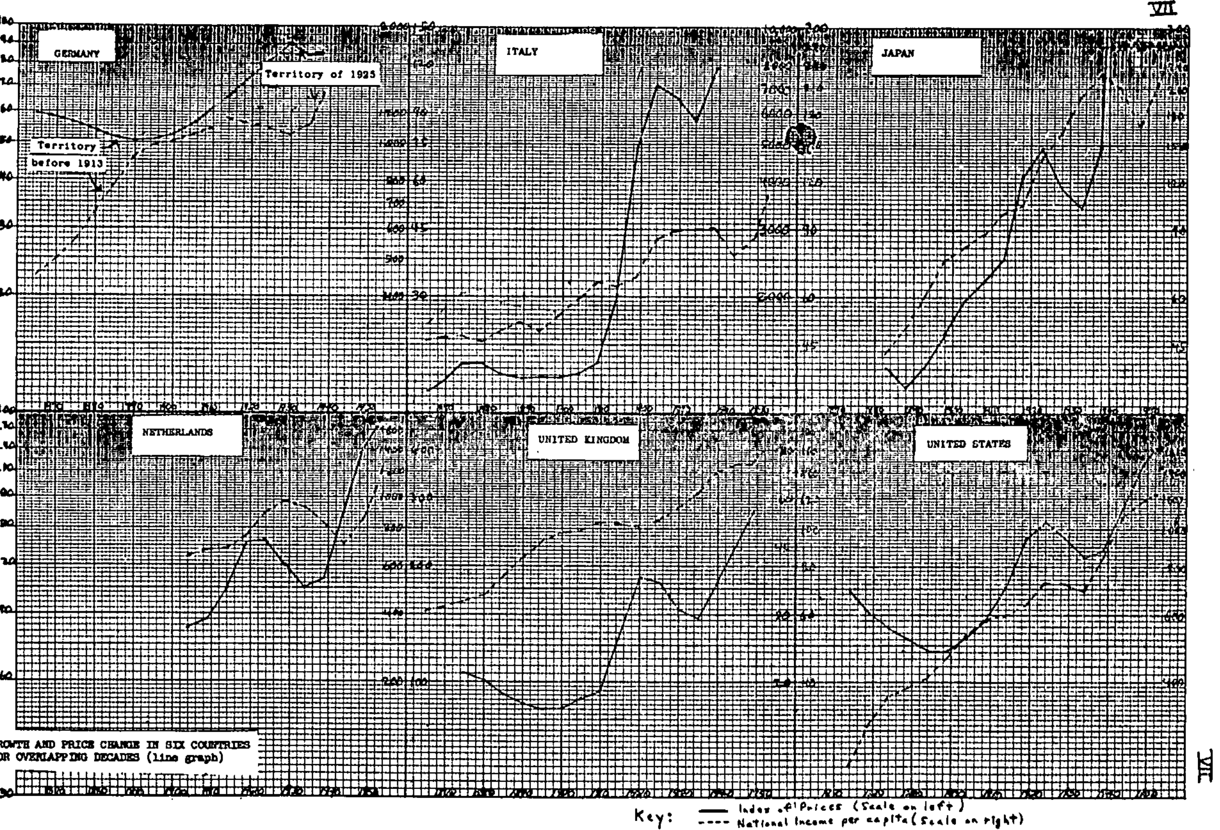
III



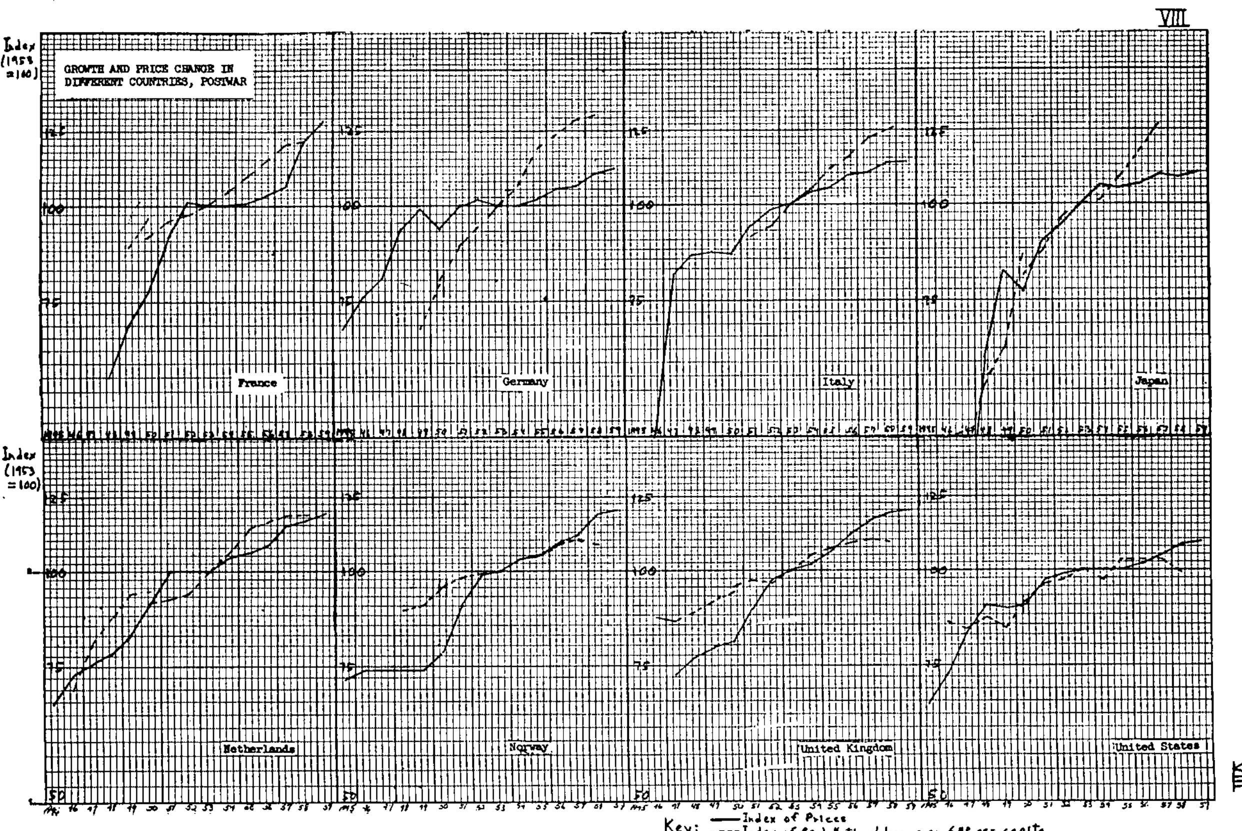
SAVING, INVESTMENT AND PRICE CHANGE
IN THE UNITED STATES, 1909-59
Per cent
30
25
20
15
10
5
0
-5
-10
-15
Ratio of personal saving to disposable income
Ratio of investment to gross national product
Rate of price change
1909
10
12
14
16
18
20
22
24
26
28
30
32
34
36
38
40
42
44
46
48
50
52
54
56
58
60


V
Per cent Change of National Income per capita
GROWTH AND PRICE CHANGE IN SIX COUNTRIES
FOR OVERLAPPING DECADES (scatter graph)
Key
Number
Symbol
Years
Country
1-13
×
1865-1941
Germany
14-31
+
1864-1954
Italy
32-45
o
1878-1952
Japan
46-55
•
1900-1954
Netherlands
56-70
□
1870-1952
United Kingdom
71-86
◊
1869-1954
United States
(% Change Between Averages
Scale: of Overlapping Decades
Scale: % Annual Change


VI
GROWTH AND PRICE CHANGE IN TWENTY-NINE COUNTRIES, POSTWAR (scatter graph)
AVERAGE ANNUAL DATA
Average Annual % Increase in Real GNP
Average Annual % Increase in Prices (GNP deflator or Cost of Living Index)
1. Argentina 1950-57
2. Bolivia 1950-55
3. Brazil 1950-57
4. Chile 1950-57
5. Ecuador 1951-56
6. Guatemala 1951-56
7. Honduras 1951-57
8. Mexico 1950-57
9. Burma 1950-57
10. Ceylon 1950-57
11. India 1950-57
12. Japan 1951-59
13. Pakistan 1950-57
14. Thailand 1951-56
15. U.S.A. 1948-58
16. Total OEEC 1948-58
17. Canada 1948-58
18. France 1949-58
19. Germany 1950-58
20. Greece 1948-58
21. Luxembourg 1949-57
22. Belgium 1948-58
23. Norway 1950-58
24. Sweden 1948-58
25. Denmark 1948-58
26. Turkey 1950-58
27. U.K. 1948-58
28. Ireland 1948-58
29. Netherlands 1948-58
VI

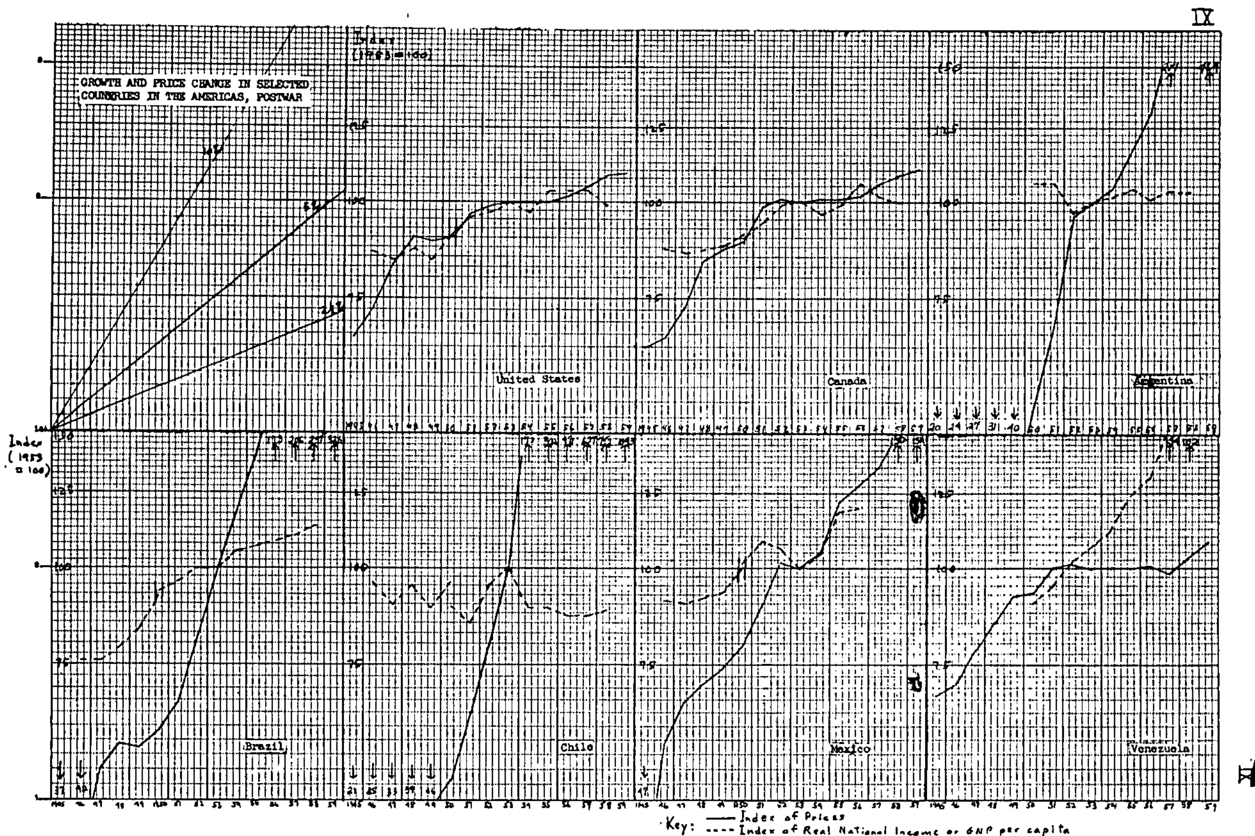


GROWTH AND PRICE CHANGE IN SIX COUNTRIES FOR OVERLAPPING DECADES (line graph)



VIII

IX



Chairman PATMAN. Mr. H. Christian Sonne, who is chairman of the National Planning Association and Vice Chairman of this Commission on Money and Credit.

Mr. Sonne, we are delighted to have you, sir, and you may proceed in your own way.

TESTIMONY OF H. CHRISTIAN SONNE, VICE CHAIRMAN OF THE COMMISSION ON MONEY AND CREDIT

Mr. SONNE. It is a pleasure to be here.

The CMC report and recommendations are based on the assumption that actual physical war with its inevitable emergency economic regulations can be avoided.

As a natural consequence of the many social and economic changes that have taken place since the deliberations of the Aldrich Commission—resulting in the establishment of the Federal Reserve System in 1913—the CMC has made a number of suggestions and recommendations that deserve serious consideration.

These recommendations appear to be based mainly on the Commission's admirable analysis of the events of the last 20 years. There may be some validity in the criticism that such a relatively short period (which may prove unusual) does not give an adequate background for farsighted recommendations.

In an attempt to see what we can learn from the past it would seem natural to analyze with great care the whole 50-year period subsequent to the report of the Aldrich Commission and also to provide a brief background of the high spots of economic history and developments of the more distant past.

Such procedure might have answered some important questions which are essential to a full understanding of the present and perhaps the immediate future. For instance, Was the great depression, with the serious unemployment of the 1930's a postwar deflation, a phenomenon as classic as a war inflation?

Was it an ordinary cyclical recession superimposed on deep-seated structural maladjustments that had their roots in the consequences of World War I?

Was the gold standard responsible for the 1930 depression—or did the British and American mismanagement of their economies temporarily destroy the gold standard?

Since a responsible, authoritative answer to these questions has been lacking, it would seem important for the Commission to carefully analyze the great depression in retrospect. The more so, because we may now find ourselves in a situation somewhat similar to that of the middle 1920's. If this is the case, we should be guided by previous experience and consider how we can avoid repeating the mistakes of the past.

A proper analysis of the background of economic history would lead to an answer to a basic question which a Commission on Money and Credit should explore deeply; namely, what should be the proper basis for money and other circulating media in the United States?

This, in turn, would lead to a useful discussion of the old and fundamental question whether money is meant merely to circulate,

to be a medium of exchange and to circulate on the basis of its temporary purchasing power, or whether it is meant to conserve purchasing power through the times.

Is money meant to be a store of value, a bridge between the present and the future?

If it is, you can properly put your savings in savings banks or bonds; if it is not, you are inclined, if you save at all, to invest in equities—for lack of confidence in money leads to speculation.

Incidentally, then you should not, either, pay off your Government debt because it becomes less and less valuable.

As a result of such an analysis, we would be enabled to appreciate the reason for the two main schools of economic thought: First, the hard money or orthrdox school (often called conservative) which, while using a variety of arguments, holds that money is meant to represent a store of value and therefore at all times should be based on goods and services; secondly, the so-called soft money or spending school (often referred to as the Keynesian school) which under various, somewhat irrelevant varieties, hold that money should merely be treated as a medium of exchange that needs no liquid collateral. In consequence, this so-called fiat money can under circumstances, which they prescribe, be spent freely through deficit financing.

The report of the CMC is clearly dominated by Keynesian dogmas, and has not even recognized or carefully analyzed the number of other possible solutions to current problems that have been sponsored by the orthodox schools.

This one-sided approach has nevertheless not necessarily presented a great handicap in finding substantial unanimity on a large number of recommendations in connection with relatively minor (often têchnical) issues. These include changes that are logical as a result of developments since the establishment of the Federal Reserve.

For instance:

Improved communication leads to elimination of classification of country banks and Reserve city banks, etc.

Relative growth of nonbank institutions (competitive equality for commercial banks, mutual savings banks, etc.)

Increased Federal debt (a more balanced maturity structure for Federal Government bonds—elimination of debt ceiling and interest-rate ceiling, etc.)

These are generally normal changes that any fair-minded group of people would agree should be made in the light of subsequent events. They are not based on any specific economic theory—except perhaps that if the changes are not made in good time, many of them might have to be made later under stress of circumstances.

Few of these recommendations are new, but the Commission may be commended for having classified them with care and for having clearly explained the need for such changes.

When, however, a report proceeds to discuss the crucial issues of our times, the choice of approach between the two main schools of economic thinking will have a profound influence on some of the proposals that are made for the solution of such issues.

If we study the objections and the implications of the footnotes of members of the Commission with care, and if we bear in mind that the

members were subjected primarily to arguments based on Keynesian theories, it is surprising and interesting to note that the majority in favor of the important conclusions of the CMC report turned out to be relatively small.

NATIONAL ECONOMIC GOALS

These important, and I may say crucial, issues are covered mainly under the heading "Economic Goals" (ch. 2) and "Coordination" (ch. 10) which I understand is the main subject for discussion today. These subjects, in turn, are interrelated to some extent with "Monetary Policy" (ch. 3) and "International Monetary Relations" (ch. 8) as well as with "The Choice and Combination of Policy Instruments" (ch. 9).

The CMC defines its "central goals" and concludes (p. 44)—

> that all three goals—an adequate rate of economic growth, low levels of unemployment, and reasonable price stability—can be achieved simultaneously, and that they are fundamentally compatible if we do not expect the impossible for each.

I also agree that morally the attainment of all three goals (including the maintenance of a satisfactory price level) was the objective of the Employment Act of 1946, but with certain important limitations set forth in the wording of that act, viz.:

> It is the continuing policy and responsibility of the Federal Government to use all practical means *consistent with its needs and obligations and other essential considerations of national policy*—for the purpose of creating and maintaining, in a manner calculated to *foster and promote free competitive enterprise and the general welfare*, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

Anybody who followed the discussions surrounding the Full Employment Act will realize that the conditional wording emphasized by me—

> consistent with—needs and obligations and other essential considerations of national policy—in a manner calculated to promote free competition, enterprise, and general welfare—

was specifically put in to protect our country against the most dangerous features of the act as it was originally proposed. As a result of changes made in conference, which produced the language quoted above, the famous Taft amendment became unnecessary.

A copy of excerpts giving the main provisions of the Taft amendment is attached. I quote some samples of it, viz.:

> (1) Sound taxation and expenditure policies to balance the budget over the next 6 years.
>
> (2) Measures dealing with control of private and public credit so that business activity may be neither inflationary or deflationary but fundamentally sound and constantly rising.

These were the kinds of safeguards which were not included in specific language because it was felt that the final wording of the act covered them adequately.

With this background, let us see what the CMC says on the subject (p. 11):

> One responsibility of Government, however, is of special interest to the Commission. The consensus reached and expressed in the Employment Act of 1946 is that—

The paragraph set forth previously is then quoted:

It is not an exclusive responsibility of the Federal Government but one that is shared with the private economy. The more fully this joint responsibility is met, the greater will be the health and vigor of the private enterprise system.

This sounds good, but I am afraid that it depends upon whether a low level of unemployment can be achieved in the manner prescribed by the CMC at a cost which, in its direct and indirect consequences, is not so appalling that it fails to be consistent with the needs and obligations and general wefare of our country.

We also have our obligations to the International Monetary Fund to consider, including the need to bring our international balance of payments on a proper basis over the years.

Have we reason to believe that we may succeed in achieving a low level of unemployment in the future more adequately than in the past while using in effect the same old method of cyclical stabilization—the theory of compensatory action that succeeds in inflating currency and prices but rarely in contracting and deflating them even though it should do so in theory?

The answer is "No" for the following reasons:

(1) The unemployment problem is gradually getting bigger and more difficult to cope with. I have pointed out in a supplementary statement that while the chronically unemployed near the peak of the recovery in 1953 amounted to less than a half million persons, they had risen to approximately 1.5 million in 1956 and to about 2 million in the beginning of 1960.

Commonsense observations, which, to me, are more important than statistics, indicate that with average production gains and no substantial change in the work week present output could be produced a year from now with about 1.5 to 2 million fewer workers than today. We must add to this the yearly influx of over 1 million persons into the labor force.

Since we must fulfill our international commitments over and above our domestic needs by working hard and intelligently, we must enlarge exports and maintain competitive prices.

This keeps the possibility of a reduction in hours of work within the narrow limits. At the same time, we must press for technological advances which would aggravate chronic unemployment.

Under these circumstances, it is no wonder that the number of chronically unemployed may exceed 2 million now and may increase at a serious rate over the years, even during the peaks of recovery periods, unless we take new energetic and wise steps to tackle the root of this evil.

(2) The anticyclical policy of "pump-priming" coupled with efforts to create money at low-interest rates can no longer be relied upon. "Pump-priming" measures may be sound under special conditions when too many goods are available while lack of sufficient purchasing power is in evidence.

The "pump-priming" theory is that temporary deficit spending adds to consumer purchasing power which, in turn, stimulates business investment. The increase in private consumer and business spending brings about recovery which permits the discontinuance of the temporary increase in Government spending. The recovery leads to prosperity and a budget surplus should then offset the deficit which has occurred during the recession. In practice, the deficit is very rarely

recovered. A "pump-priming" policy is not sound when there are structural maladjustments and when basic urgent needs exceed the goods and services that can be made available.

The anticyclical policy of the 1930's was conceived at a time when temporary increases in public works were believed necessary for priming the pump of a free enterprise system. After tax rates became high in the post-World War II period, temporary (automatic and formula determined) tax reductions were regarded as the panacea. (The CMC Report devotes pp. 131 to 137 and several recommendations to this subject.) Now we see that anticyclical measures are no longer sufficiently effective because their temporary "pump-priming" effect does not result in employment of an increasing number of the chronically unemployed. In failing to recognize these facts, the CMC Report is not up-to-date—indeed, it is grievously behind the times.

(3) Understanding the problem of achieving the three national economic goals is complicated by the failure of the Commission to stress adequately (on p. 17) the stern necessity for our Government to find a way of coping properly with market power. The crux of a full employment program is a sound wage and price policy. Legislation that curbs market power should disturb democratic processes as little as the Sherman Act caused constitutional difficulties.

(4) Still further complications are added by the CMC's statement (p. 31):

> Although not satisfied with recent rates of growth, the Commission does not recommend the establishment of any specific rate of growth as a target.

Such an attitude is not helpful. An increase in GNP of $10 billion, or, say, 2 percent, equals a $3-billion increase in Government revenue. A growth target would enable our Government to estimate what it can afford to spend in the process of stimulating growth. Growth is the only painless source of additional taxes.

This attitude on a growth target is the more surprising when one reads under "Stablization Policy Mix" (ch. 9, p. 252):

> The general objectives of stabilization policy are to maintain levels of demand which will lead to low levels of unemployment without inflation. Not only is it necessary to have a demand target, but allowance must be made for the margin of error between the actual and the predicted course of events.

So, according to the report, we must have a target for demand that may produce jobs; but we may not have a target for growth that certainly would produce jobs in a more direct manner.

(5) Other suggestions in connection with "The Choice and Combination of Policy Instruments" (ch. 9) are well conceived in theory and might have been useful in the past.

Their practical usefulness in the future is doubtful because (*a*) the economic diagnosis must be correct for the prescription to be useful. We all know that in practice it is extremely difficult to make a correct economic diagnosis. (*b*) It is difficult to visualize who is going to determine when and how the various steps are going to be taken. If group action is contemplated, we face the difficulty of reaching agreement because inaction is safer mainly because (*c*) it would call for almost superhuman alertness to carry some of the theories into practical effect. (*d*) These so-called "long-run policy mixes," are apt to become increasingly complicated. The reason is that once we

start to interfere with interest rates and natural market conditions, one interference is apt to result in some unbalance elsewhere which then, in turn, needs correction. We must remember that wrong ideas are apt to beget still worse ideas—they tend to chase right ideas out just as bad money chases good money out of circulation.

I fear that in practice the well intentioned policy mixes of chapter 9 are not apt to be of any material use in our effort to be more successful in achieving our three national goals.

Under the above five headings I have outlined some of the main reasons why, in my view, monetary, credit, and fiscal measures—conducted along the lines now pursued and those recommended in the CMC Report—cannot be more successful in the future than in the past in achieving our three goals of adequate rate of economic growth, low level of unemployment, and reasonable price stability.

We are told, however, in the concluding paragraph of chapter 2 (p. 45) that while monetary, credit, and fiscal measures to influence the level of demand are "essential ingredients" for the attainment of these goals—

> other Government measures are required to supplement monetary, credit, and fiscal measures.

The question then arises: What are these "other Government measures?" Under future prospects (p. 29) we find among the factors listed on the favorable side the following: increased Government interest in education and training, improved information programs on job availability, and some increased mobility of workers. Later on we find a suggestion (p. 39, last paragraph) reading as follows:

> The Government could provide better information for matching men and jobs through an improved employment service, eliminate discrimination against particular groups of workers, provide retraining opportunities for workers displaced by technical change, and help move workers out of, or industry into, depressed areas. These measures should improve labor mobility and should reduce localized shortages of labor at a given level of unemployment.

These are praiseworthy suggestions which in time may be helpful—particularly when we know for what kind of work the unemployed should be trained; to what places they should go to find a job when increased mobility is provided for; and when an improved employment service actually has suitable jobs to offer. These facilities and the elimination of discrimination are mainly long-term issues that will be helpful if and when we reach the target for low-level unemployment which is defined (p. 28) as—

> somewhere near the point where the number of unfilled vacancies is about the same as the number of unemployed.

Pending such time in the future these "supplementary" Government measures would appear in practice to be relatively ineffective for achieving the three national goals. In the absence, therefore, of some new or other important tasks not mentioned in the report that the CMC has alloted to the Government, we must conclude that during the immediate future the burden of achieving our three national goals will, for all practical purposes, have to be carried by means of monetary, credit, and fiscal measures.

This is a burden which, as we have seen, these measures can carry as little in the future as in the past.

Quite apart from the admitted failure in the past to reach our goals, our performance has been an extremely costly affair both from a direct and indirect point of view. During the postwar years of the 1950's we have been facing frequent moderate booms and recessions, increased unemployment, a lagging growth rate, creeping inflation, and balance-of-payment deficits. Our Government debt has increased from $275.2 billion in December 1953, to $290.4 billion in December 1960. Our reserves of gold minus net foreign short-term liabilities amounted to $19.6 billion in December 1953; they have shrunk to $0.6 billion now. (No deduction has been made for the approximately $12 billion of gold required as backing for our currency.) I am inclined to forget that of our approximate 140 billion circulating media (currency and bank demand deposits) a greater and greater percentage up to 50 percent represents fiat money, namely, purchasing media derived from monetization of the Federal debt, from real estate, security, and consumer loans granted by the commercial banks as well as from their investments in obligations of corporations and State and local governments.

The size of the investment account of the Federal Reserve System under "Loans and securities" gives a picture of the extent to which buying to create money easiness has exceeded the sales to create money stringency. This figure is, therefore, looked upon by many keen observers as a key indicator of the trend of inflationary conditions.

The Federal securities owned by Federal Reserve banks rose from 2.2 billions, June 1941, to 20.8 billion, December 1950, resulting in an increase of over 18 billion. This move itself could create inflation to the extent of six times the amount; or of over $100 billion.

It would be unreasonable to criticize these increases during the war emergency and both schools of economic thought regarded the consequences as an inevitable wartime inflation.

Since then the figure has risen by over 6 billion that could create over 35 billion additional inflation. It is undeniable, therefore, that the last decade had resulted in regrettable and probably unnecessary inflation.

This gives a rough picture of the costs we have faced in our effort to achieve our three national goals.

We may view this past inflationary trend in terms of the contention of many keen economic observers that—

> a democracy cannot control inflation by means of a "managed money policy" and remain a democracy.

This applies particularly to a mass democracy and seems to be confirmed by history.

From this viewpoint, the CMC statement on page 13 reading:

> There is every reason to presume that the Federal Government will avoid the kind of excesses that lead to galloping inflation—

seems unfortunate and unrealistic.

Since our gold reserve—accumulated in the past—for all practical purposes has been used or pledged, we can no longer afford costly "pump-priming" experiments which may lead to inflation. The time has come to call a halt—for otherwise it will not take long before we shall find that our gold reserve and international credit facilities are exhausted and that we will be compelled to introduce exchange control.

Exchange control is a source of many social and economic restrictions and evils. So much so that—

there is a fundamental conflict between exchange control and human liberty.

A quotation from Lord J. M. Keynes' "Essays in Persuasion" is illuminating. Says he:

Lenin is said to have declared the best way to destroy the capitalist system was to debauch the currency * * *. Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency.

Quite apart from many international political dangers, we are facing great difficulties in withstanding the economic consequences of the cold war—if necessary, for a long period, and simultaneously in living up to the spirit and obligations of the International Monetary Fund.

In view of these great difficulties,we must not weaken ourselves unnecessarily by seeking to achieve the objectives of the Employment Act without considering the safeguards written into the act. The clearly limited promises of that act must not be abused or taken advantage of for the promotion of unsound policies.

Thus, it is unfortunate that the CMC report states on page 29 that "among the factors on the favorable side (for achieving adequate employment) are the stated responsibility of Government embodied in the Employment Act," but does not point out simultaneously the limitations on that responsibility which are in the act—namely, that its application must be consistent with the Government's needs and obligations and other essential considerations of national policy.

I am of the opinion that the recommendations of the CMC for achieving the three goals—an adequate rate of economic growth, low levels of unemployment and reasonable price stability—are not valid in terms of domestic and international problems which this country now faces. In this respect they are impractical and naive. A careful analysis of the Commission's "Alice in Wonderland" philosophy clearly shows that the consequences of their suggested procedures would not fall in line with the full intent and wording of the Employment Act of 1946. The means suggested would not result in measures that are "consistent with the needs and obligations and other essential considerations of national policy," nor would they in the progress "foster and promote free competitive enterprise and the general welfare."

For these reasons I found myself unable to approve of the CMC's recommendations on the subject of "National Economic Goals."

AN ALTERNATIVE

The circumstance that we can neither accept the recommendations of the CMC nor continue with safety our present policies for achieving our three national goals does not mean that we should abandon these most important goals. It is clearly not alone the wish but the obligation of our Nation to do our utmost to find a sound and practical way of implementing the full employment aspects of the Employment Act of 1946.

Unless we have actual physical war, with its demand for manpower, the unemployment problem is one of great urgency. I, therefore,

consider it most important for the CMC to tackle that problem realistically. Since, in my opinion, the CMC did not perform this task satisfactorily, I have prepared a supplementary statement to show one of the ways in which the problem could be solved in a manner designed to comply with all aspects of the Employment Act. The suggested procedure is built around three main observations:

(1) That world events in recent years—both politically and in the economic field—have clarified a number of issues to the extent that open-minded students of the two schools of economic thought, which I have described, should be able to find a common basis of action.

(2) That economic growth should be made the one major goal, because a sufficiently rapid rate of growth will make much less difficult the solution of the two other goals—a low level of unemployment and price stability.

Moreover, adequate growth is needed, in any case, in support of the following aims: the strength of the Nation, its well-being, and its survival. High employment will be provided, so to speak, as a byproduct of growth.

(3) That the best and most realistic thinking of both economic schools of thought can be combined, in my opinion, to suggest at least one way in which we can achieve two important purposes, namely: (*a*) to stimulate growth and consequently full employment in a manner that will not carry inflation in its wake; and (*b*) to strengthen the dollar gradually and over the years in a manner that will create valid confidence, both at home and abroad, in the stability of our economy.

Moreover, in considering organization and coordination, it is visualized that a top planning body is likely to be created which considers the Government program as a whole, and economic needs are apt to become an increasingly important part of such top level deliberations.

To facilitate the pratical execution of his task, it is recommended that the President give consideration to the setting up of a Council along the lines of the Advisory Board on Economic Growth and Stability substantially in conformity with the recommendations made in chapter 10 of the CMC report.

It is urged that this Council pay special attention to the many facets that have a bearing on economic growth.

The "supplementary statement"—which is at your disposal—was drafted in the hope that it may be used as a basis for discussion and lead to some—perhaps entirely different—plan of action on the basis of which our economy can proceed with the full implementation of the Employment Act of 1946 with a fair expectation of success.

CONCLUSION

The Commission has worked hard and conscientiously on its report and set forth a number of recommendations that deserve serious study. In the process of analyzing this report I fear that we shall fail to find a practical solution for the most crucial economic issue that we face in the coming decade—namely, the achievement of our three major national economic goals.

For this reason I prepared my "supplementary statement" in the hope that it might be considered simultaneously with the report. I was also motivated to do so because of my feeling and conviction that the economic situation of the country is so serious that prompt action is imperative.

Chairman PATMAN. Thank you, Mr. Sonne.

I would like to ask you a question about the makeup of the committees.

The selection committee, Mr. Robert D. Calkins was chairman; he is the president of the Brookings Institution?

Mr. SONNE. That is right.

Chairman PATMAN. And on that committee there were 10 members, including yourself?

Mr. SONNE. That is right.

Chairman PATMAN. That selection committee, as I understand it, selected the membership of the Commission, consisting of how many members?

Mr. SONNE. I think originally 15 or 18, I forget.

Chairman PATMAN. And then later about 25, I think. And how were they selected? Did you actually vote on them or how were the names considered?

You actually had a meeting, I assume?

Mr. SONNE. Yes.

The selection committee really worked very conscientiously. I think we went over hundreds of names of people that would come into question, and then out of those we reduced them from, let us say, 200 to 50.

Then we went over them carefully again and reduced them to, let us say, 20.

Chairman PATMAN. In doing this, did you have a subcommittee to do it or did all 10 members do it?

Mr. SONNE. I think all 10 members.

Chairman PATMAN. You were present there?

Mr. SONNE. I was present; that is right.

Chairman PATMAN. How was Mr. Wilde selected as chairman?

Mr. SONNE. You see, we did not select the chairman. We selected a body of, let us say, 15 or 20 people. We did not say that, of this body of men, so and so should be chairman.

Chairman PATMAN. How was he selected chairman?

Mr. SONNE. The history was that first a number of those selected refused and then we increased the number to 25. We met, and I think of the two founders, one was the Ford Foundation which gave us the money, and the other was the Committee for Economic Development which also gave certain money and recommendations. I think it was the latter that had something to do with recommending that Mr. Wilde should be the chairman.

Chairman PATMAN. The Committee on Economic Development?

Mr. SONNE. Yes, I think so.

Chairman PATMAN. The Committee on Economic Development, of course, put some money into this, too.

Mr. SONNE. That is right.

Chairman PATMAN. I believe originally it was $1,300,000 that the Ford Foundation put in.

Mr. SONNE. About $1,300,000, and then some other organization put in about $50,000.

Chairman PATMAN. Another foundation put in?

Mr. SONNE. A smaller amount.

Chairman PATMAN. The Merrill Foundation?

Mr. SONNE. Yes.

So you got up to about $1,400,000.

Chairman PATMAN. And then I thought I understood Mr. Wilde to tell me that they spent $2 million, but evidently I must have misunderstood him, because here the other day, when asked that question, he said they spent about $1,500,000. What is your estimate of it?

Mr. SONNE. They certainly spent $1,500,000, but I should think that the question of $2 million arose because the Committee for Economic Development helped us a great deal in giving free space.

They gave us a great deal of help with their secretaries, then the printing, and so forth. So I am not sure it is a gross exaggeration to say, that if we had been entirely on our own, it would have gone to $2 million.

Let us say between $1.5 million and $2 million.

(Subsequently, Mr. Sonne submitted the following additional remarks:)

Let me draw your attention to a paragraph in the "initial announcement" made by Mr. Donald K. David, chairman of the board of the Committee for Economic Development on November 21, 1957. It reads as follows:

"I am happy to announce that the board of trustees of CED, by a special ballot, has authorized the creation of just such an independent board of competent and objective citizens to explore 'the whole financial terrain.' I am happy also to announce that the Ford Foundation has set aside half a million dollars for the use of this independent, national Commission on Money and Credit. In addition, another half million dollars will be supplied to the Commission by CED and other cooperating organizations. More financing is expected to be required and is being sought."

Subsequently the Ford Foundation arranged for a supplemental grant of $800,000, making their total contribution $1,300,000, and the Merrill Foundation gave $35,000. There was thus raised in cash altogether $1,335,000.

In view of Donald K. David's statement, "In addition, another half million dollars will be supplied to the Commission by CED and other cooperating organizations" it would not be unnatural to add this sum to the $1,335,000 collected from foundations, making the total $1,835,000, or close to $2 million.

I believe that this is the reason why at one time it was felt that close to $2 million would be spent. If the CMC had worked entirely independently and had been compelled to face the printing bill themselves, a sum close to that might have been used.

As matters turned out, and in view of the report being printed through commercial publishing channels, it is probably fair to say that the total actual costs ranged somewhere between $1½ and $2 million.

Chairman PATMAN. It is my understanding that you have a certain amount set aside to give publicity in your public relations department. How much money do you have set aside for that?

Mr SONNE. I regret to tell you that my position has been like the Vice President of the United States. As long as the President lives he decides.

I am not aware of any money lying there for the specific purpose of what you may call "spreading the gospel." The Committee for Economic Development helped in getting this printed, and I think that was one of the things that they would have done themselves and paid for.

But then they got a private organization to print it, to which I had no objection.

Chairman PATMAN. Would it be satisfactory with you, Mr. Sonne, if I filed some questions with the reporter so, when you get your transcript, you can answer them at the same time you look over and approve your transcript of testimony?

Mr. SONNE. I would be very glad to.

Chairman PATMAN. And will it be satisfactory for the other members to do likewise if they want to, other members of the committee?

Mr SONNE. OK.

(The questions and answers referred to are as follows:)

Question 1. Mr. Sonne, I believe that you were not only a member of the CMC, you were also a member of the selection committee who selected the membership of the CMC?

Answer. That is correct.

Question 2. I asked Mr. Frazar Wilde on Monday several questions about the selection and how they were made, and he was unable to tell me. Maybe you can tell us.

First, just how did the selection committee go about chossing the membership? Did it operate from a list of nominations, or did it choose from a list of nominations made by someone else and, if so, who made the nominations?

Did the 10 members of the selection committee vote on the members and was the majority vote required, or what?

Answer. (*a*) The selection committee held two meetings (December 7, 1957, and February 14, 1958) at which all 10 members were present. Apart from a list of many names (which anybody including our secretariat could prepare as a matter of routine) each member had a right to—and most members actually did—propose one or several prospective candidates for discussion. This resulted in the first round in a great number of possible candidates (I believe several hundred) that all were considered as possible timber on the part of one or more members of the selection committee.

As a second step this number was greatly reduced—after full discussion—to a more limited number (I would judge to 40 or 50 names).

In the third round this number was again reduced to the approximate number which was called for according to the announcement of the chairman of CED dated November 21, 1957, namely, from 9 to 18 members, i.e., maximum 18—possibly with a few substitutes in case some of those invited were unable to serve.

(*b*) In the absence of full agreement on the individuals to be selected—the majority rule would probably have applied. In practice this did not become necessary probably because there were a greater number of men than we needed for the CMC that seemed qualified. Therefore, as I recall it, if any one member of the selection committee expressed a strong objection to any particular suggested candidate—the name of such candidate was withdrawn. Although perhaps not definitely expressed, I believe that all members of the selection committee felt as I did, that generally speaking, the members of the selection committee should not be candidates for membership of the CMC. I recollect that I suggested to make one exception and tried to persuade one of the gentlemen to serve, because I felt that his experience in close contact with the Government would be very valuable to the CMC. He declined and gave as one of his reasons the fact that he was a member of the selection committee.

For the reasons given it follows that those that finally were invited had been unanimously approved by all members of the selection committee.

Question 3. What was the standard of criteria used, if any, for choosing people to be members of the Commission?

Answer. Individual capacity, ability, and knowledge either in the practical business or professional fields or in the conomic field—preferably in both, coupled with a record that would tend to indicate that the candidate would put the national interests ahead of group or individual interests.

Question 4. Mr. Frazar Wilde told us that the selection committee chose him to be a member of the Commission, but he does not know who chose him to be Chairman of the Commission. Could you enlighten us on that?

Answer. (*a*) The selection committee included Frazar Wilde in the original list of maximum 18 to be invited. In accordance with the first paragraph of section 1 of the bylaws governing the CMC all members were appointed by the

Chairman of the Board of Trustees (meaning by Mr. Donald K. David, chairman of Committee for Economic Development) *"with the advice and consent of a selection committee."*

The selection committee was not called upon or expected to select a chairman of the group because—

(*b*) Section 1 of the bylaws referred to above states in the fourth paragraph: "The Chairman of the Commission, and a Vice Chairman or Cochairman, shall be appointed by the chairman of the board of trustees (again meaning the chairman of CED)." There is no stipulation that such appointment of the chairman should be subject to "the advice and consent of a selection committee."

This seems quite natural because the Chairman of CMC would have to handle a number of practical problems arising from the CED's several promises of support. It seems logical, therefore, that CED should have a right to choose a Chairman most satisfactory to them from the members invited "with the advice and consent of a selection committee."

It follows that Mr. Frazar Wilde undoubtedly was chosen and appointed to be Chairman by the chairman of the CED.

Qestion 5. How did you come to be Vice Chairman?

Answer. When the selection committee had decided on what was then expected to be the final list of approximately 18 individuals to be invited to become members and when the committee had set forth a brief outline of the task of the CMC we considered that the work of the selection committee was done and consequently I lost touch with the developments. A few months later, however, I was consulted because it developed that of the 18 invited, a number of those who were considered as "liberals" had refused to serve.

The feeling prevailed that, the more the members of the CMC could represent a wide range of economic interests as well as an adequate geographic pattern, the greater would be the likelihood that the CMC's findings would be of value to the Nation. It was feared that the reduced number might prove to be too small, perhaps too one-sided, and suffer from the absence of representation, for instance from labor. If such liberal representation were to be included it was felt they should not be in too small a minority and also, that there should be added a Vice Chairman with whom they had had satisfactory experience in the past.

Since I had been chairman for many years of the NPA, which includes in its program national committees representing agriculture, business, and labor, it was not unnatural that the choice fell on me and that I was asked to (1) help in gaining acceptances that would establish a proper balance of representation and in the process increase the number of members of the CMC to 25, and (2) become a member myself and agree to become Vice Chairman of the CMC, with Mr. Frazar Wilde already designated as Chairman.

Although I regarded the position of Vice Chairman as a mere formality—unless unexpectedly something serious should happen to Mr. Frazar Wilde—I nevertheless accepted the membership of CMC with great reluctance partly because I had been a member of the selection committee, and partly because of my many other duties in connection with nonprofit organizations.

Question 6. Who selected the top staff of the Commission? Were these selections made by vote, or did the Chairman select them, or you and the Chairman, or just what was the process?

Answer. The Research Director was selected by the Chairman. The Deputy Research Director was, I believe, selected as a result of the combined efforts of the Chairman and the Research Director, who obviously should have a compatible deputy.

It is well in this connection to bear in mind that—also at that time—it was very difficult to find such a top staff. It is quite a big undertaking, both from the point of view of the knowledge, and experience that is required and from the angle of the time—probably several years—that must be available. Hence the CMC had quite some difficulty and spent a relatively long time in selecting the best top staff available.

I approached the confirmation of the selection of the top staff—in the same way as practically all other matters of the CMC—mainly from the point of view of a regular member of the Commission.

As such, I, and—I believe—practically all other members of the CMC were pleased at the time. The selection of the top staff was approved by a unanimous vote.

Question 7. Who chose the work assignments? I mean, by that, task force assignments of the members, and who chose the heads of the task forces?

Answer. The subject that the Research Director felt should be covered was broad and time consuming. In many cases, facts and details had to be carefully analyzed. For 25 people to sit constantly as one group to cover such vast material adequately would be waste of time and energy.

The subject divided itself quite naturally into six or seven sections for which working groups, which we called task forces, were organized. This was one way (there might have been several other ways) or procedure, which might lead to a satisfactory result if it were understood, as was the case in the CMC that—

(*a*) The task forces were merely a temporary measure for getting the Commission organized sufficiently to think matters through. Each task force might come to certain conclusions within their specific orbit that might be perfectly sound from their angle but which nevertheless—when taking the view of our economy as a whole—would not necessarily stand the test of time and would have to give way to more important problems and recommendations of other task forces; i.e., to other important problems of our economy.

Therefore in the final discussions the preliminary recommendations of the various task forces would be reconciled and in the final process the task forces would lose their identity. The final report and its recommendations should, therefore, not necessarily show any trace of the temporary task forces.

(*b*) To each task force was assigned those members that it was felt were particularly adapted to the subject involved. It was felt that generally each member should be a member of two task forces with a view of securing a certain coordination between them from the start.

(*c*) Any member of the Commission had a right to join any task force meeting irrespective of whether he was officially a member of the task force or not.

(*d*) The decisions or recommendations of a task force was consequently not binding on the Commission which in the end would have the opportunity and right to vote for or against any proposal of any task force.

On this background the actual membership of the various task forces did not become a matter of great importance. I think it solved itself to a great extent by each individual joining those task forces in the work of which he was most interested and, therefore, probably most competent.

The chairman of these task forces were picked out mainly by the chairman, in cooperation with the members of the Commission who formally approved of the appointments at a meeting.

The temporary setup of the task forces has been dealt with at some length to clarify questions:

Question 8. Now tell us how the propositions which got put before the Commission for decision, got put before the Commission. If the task forces chose those propositions that the Commission was to take a position on, then who chose the propositions that were put before the task forces?

Answer. It follows from the division of the field of work that most of the propositions with the Commission on Money and Credit eventually dealt had their root in the discussions of the task forces; most of these questions would crop up there almost by themselves. To each task force was assigned at least one member of the staff—often a junior economist. He would prepare a memo on the particular field of the task force. It would be discussed and criticized. As a result there would appear, at a subsequent meeting, a second draft, then a third and fourth until all the various views and recommendations of members had been set forth and reconciled.

It follows that the proposals of the task forces to some extent were initiated by the staff but that members of the task forces often to a great extent changed the original suggestions and often conceived new ideas that resulted in constructive recommendations.

This would not exclude that later on some proposals were made or changed by the Commission as a whole and then perhaps from there were sent back and inserted in the statement made by the corresponding task force.

Question 9. Now on the question of the voting and what constituted a quorum, were formal votes taken on all the recommendations that the Commission made?

What constituted a quorum at your meetings and were there any meetings that took a position which was later overruled by the full Commission?

Answer. (*a*) Since dissent and footnotes were an inherent right of members and since on a subject of this kind full agreement rarely is attainable, it seems

logical and less time and space consuming in connection with footnotes and dissents, to follow the course with which 50 percent or more seemed to agree.

(*b*) On all important problems and proposals that seemed to be controversial, a vote was taken.

(*c*) On important issues and when there appeared to be a narrow margin a second vote was taken—including the vote from members that happened not to be present when the first vote was registered.

As a result there were cases where a position previously taken subsequently was changed. Such a change in position might also result from occurrences that meanwhile had taken place and that had been bought to the attention of members.

Chairman PATMAN. Senator Douglas?

Senator DOUGLAS. There are two questions I would like to ask. The first is this: If we do not have war, and, of course, we all hope that we will not have war, and if growth is to be the primary goal which is expected in your view to solve the problem of unemployment and also a stable price level, and growth, in turn, is to be dictated by consumer choices, largely, does not this mean that growth in the future will take place primarily in the field of services rather than in the field of material goods?

We know that the income elasticity for food is quite low, probably not more than 0.25, so that each increase of 1 percent in income per capita is accompanied by an increase of only one-quarter of 1 percent in the quantity of food demanded. I suspect that the income elasticity for most manufactured goods is now less than unity.

This is reflected in the fact that the number employed in manufacturing more and more is a smaller fraction of the total working population.

But the income elasticity for services, entertainment, recreation, health, education, art, culture, drycleaning, and so forth is very much greater than unity.

Will this not mean that economic growth will take a very different form from what we have thought of in the past, where we regarded it as primarily an accumulation of machinery, plant equipment and so forth, and, as a matter of fact, if this occurs, will we not need a smaller and smaller fraction of the total gross national product to be invested in what is called fixed capital?

In other words, you make growth the aim instead of what I think is more desirable, namely, as one of the aims. Does this not lead us into, inevitably, a changed composition of the national product, where we emphasize services, and somewhat minimize the relative importance of agriculture, which we have already seen, manufacturing and mining?

Mr. SONNE. I would like to answer the question this way:

When you talk about a solution of this problem and try to say that in three paragraphs, you naturally have to skip over a number of even fundamental things.

My feeling is that when we talk about growth and when we talk about growth in the past, then we did think of machinery, but we also thought of what comes out of this machinery—motor cars, liquor, lipsticks, and all that.

And I ask myself today, where we face, to my mind, a very serious world situation, whether I would be particularly pleased if I heard that now, instead of one for each family in America, we have two cars and so on, luxuries, and, therefore, I start out by saying that

when you talk about growth, you must differentiate between two kinds of growth.

One is useful growth, and under "useful," I mean improved schooling, improved hospitals, improved roads, urban renewal training, and so forth.

The other is what I call pleasant growth, which includes lipsticks for the ladies, and tobacco, motorcars, television, etc.

Senator DOUGLAS. I have stopped smoking myself, but I am not proposing to prohibit others from smoking. We must allow freedom of choice to the consumer, and this will mean that there will be many services, many goods produced, which we may disapprove of.

Mr. SONNE. And then I go on and say that in a democracy, particularly a democracy that works for survival, it becomes the decision of Congress in the last analysis as to how to make this mixture, and what they finally decide I call healthy growth.

It will probably be a little of each, but I have particularly stressed that under public expenditures, we probably will in the future find that Congress wants to spend more than under pleasant expenditures, because we need to strengthen this Nation so that we can withstand the attack from outside.

I am talking about the moral attack.

There is my answer to the question of growth—that it ought to be analyzed.

Senator DOUGLAS. I am not certain it answers it, but it points in the direction. Do you mean to say that growth in the future will require universities and scientists and art galleries and national parks and so forth, and not merely machinery?

Mr. SONNE. I would go along on that, except that I would say I hope that we can get the national parks and galleries in a little later, but there are many things that are more important.

Senator DOUGLAS. Such as?

Mr. SONNE. In other words, scientists are of the first importance, roadbuilding, communication, hospitals. We have, in effect, so many things that we ought to do in this country. In the National Planning Association we have figured out that the problem of urban renewal and transportation is very great and our economy could really, for at least 10 years, absorb all the surplus labor in this country just to settle that one thing. So much so that we find that we now have to work hard on letting first things come first—everybody wants to do everything— and see at what stage can we introduce the delightful parks that you want, Senator.

But there are many things that are more important.

Now, at this juncture, I think it is perfectly unforgivable that we have all these millions of unemployed, and we try to solve the problem by creating demand when we run the risk that that demand will be whisky and tobacco, although you do not smoke, and lipsticks.

I like to see growth and to see that we really get the people to work on the proper things to strengthen this Nation.

Senator DOUGLAS. I used to read John Ruskin a good deal, and, of course, Ruskin said that a good deal of so-called wealth was really illth and did not contribute to well-being.

But what is one man's wealth is another man's illth and vice versa. And unless one has rather rigid control of what can be produced, and if one permits freedom of consumer choices, it is what people want, whether good or bad, that will dictate what will be produced. Naturally, we will try to have people want the things you mention. I would not legislate about it.

Mr. SONNE. May I make it clear that I suggest nothing undemocratic. I do not say that we should go out and forbid people to smoke or anything like that. But we are already doing it by putting an extra tax on tobacco and liquor.

In other words, all we can do is to stimulate a desire to do this and to try to curb a desire to do the other. I certainly do not want to lose the democratic processes.

Senator DOUGLAS. Mr. Sonne, there is just one more question, and it is primarily directed to page 12, but I think it runs through all your paper.

You seem to think that there has been inflation because the supply of currency and demand deposits has increased. On page 12, you say:

> It could create over $35 billion additional inflation.

Now, while that creates additional monetary purchasing power, is that inflation if it is matched by a corresponding increase in the quantity of goods?

I have always thought inflation consisted of a rise in the price level caused by a greater increase in the active quantity of money than in the quantity of goods which the money is used to purchase.

But now you seem to think that any increase in bank credit aside, and purchasing power aside, from gold is inflation.

Mr. SONNE. May I answer that?

Senator DOUGLAS. Yes; please.

Mr. SONNE. If that comes out on page 12, that is not what I mean. I do not know what you refer to, but I say that the reason we have inflation is that a lot of those banknotes and demand deposits, deposits of the bank, are not based on goods and services—I think you used another expression but meaning the same thing—but are based on long-term bonds, government loans and purchases of and loans to municipal governments. When we started the Federal Reserve bank, the underlying idea was that under each banknote and under each deposit which the bank gave there should be loans that either had goods and services behind them or had in industry the expectation of having goods and services within 3 to 6 months.

Chairman PATMAN. Known as eligible paper?

Mr. SONNE. Eligible paper.

Now, they say we cannot do that because acceptances are impractical. The bankers' acceptance was merely one way of doing it, but the principle remains the same whether you have a note or other evidence that the bank should have as collateral what you may call current goods or services that come in within 3 months, 6 months, or the maximum of a year——

Senator DOUGLAS. What would you do, Mr. Sonne?

What would you have as the medium of exchange?

Mr. SONNE. Much the same as what we have now.

Senator DOUGLAS. The same as now?

Mr SONNE. As we have now, but I would say that no commercial bank should be permitted to use its deposits and go out and give a 5- or 7-year loan against an industrial building, because that money ought to come from the savings banks. Here we fool ourselves.

We think that we have goods and services behind our dollar and we have not.

Senator DOUGLAS. In other words, you would say there should be a sharp distinction between commercial banking and investment banking?

Mr. SONNE. Yes. That is what savings are for.

Senator DOUGLAS. And that investment banking should be financed by savings?

Mr. SONNE. Yes, sir.

Senator DOUGLAS. Withdrawn from current income?

Mr. SONNE. That is right.

Senator DOUGLAS. And not financed by the creation of additional monetary purchasing power?

Mr. SONNE. That is right.

And if you have read the discussions of the Federal Reserve, it was interesting that there they discussed whether occasionally you could issue some notes against Government bonds, and they finally came to the conclusion that you may take, I think, up to about a half a billion of these very short-term bonds on the theory that if absolutely pressed, the Government could produce either gold or accounts receivable for this amount. And now I ask you whether we can within 3 to 6 months produce goods and services for $290 billion of our own Government notes.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I want to thank Mr. Sonne for putting this whole report in context, as I have felt that it was not in context, and I want to read for the record what you said:

> The report of the CMC is clearly dominated by Keynesian dogmas. Few, if any, on the Commission's Advisory Board or among its staff and outside consultants seem to have been chosen from among the many prominent and able orthodox economists; nor has the report even recognized or carefully analyzed a number of other possible solutions to current problems that have been sponsored by such conservative economists.

I share your view, sir, and I might say that that has been a great deal of the trouble in public debate today at the national level.

It seems that the Keynesians do not want to debate the subject. They want to contend that the dispute is solely among themselves.

I regard it as dishonest scholarship, and I wish that they would face up to the arguments and reasons that orthhodox economists, if that is the correct term, or at least those who fundamentally disagree with them, advance as their theories. I am willing to debate them myself within my limited abilities, but I find they try to win the debate by misstating the premises and claiming that there is no dispute.

So I want to thank you for that, sir.

Now, one question—there are a number of questions—one thing that I was interested in where I find I disagree with you, as I am sure that there are areas where we would disagree, where you dis-

agree with the Commission's refusal to set a percentage or growth goal.

Here is why I have felt that we should not set a goal. It is not that if we could not, it would be good, but what is "growth"? How do we measure it?

You see, the people who set these goals like to measure growth in terms of gross national product, and I do not think that statistical series lends itself to an accurate measurement of growth.

Let me illustrate three of the factors that, I think, better measure what growth is.

(1) And the specific statistic is possibly not very exact, but it has been quoted, 30 percent of the goods and services on the market today were not on the market 5 years ago. Now, I do not know what the percentage would be, but it is a very sizable one, but that would be an indicator of growth, in my judgment.

(2) The fact, and this is again a statistic that probably is somewhat inexact, as I do not know how we would measure it, 30 percent of our machinery today is obsolete. But whatever the percentage is, the obsolescence of machinery and equipment and the rapidity with which it is becoming obsolete would be an indication of growth.

(3) A third one which I refer to is increase in productivity, but relating it to an area. One man produces the food and fiber that used to take five to do. So we have a rural unemployment situation.

But those are the kinds of factors that I think we have to use to try to determine whether we are growing rather than these aggregates, like gross national product. It is that reason that I have questioned the wisdom of setting a growth goal. So I appreciate your comments.

Mr. SONNE. I would agree with you; when you sit and talk about growth, then you have got to ask, What do you mean by "growth"? Growth, for instance, in the way of personal services, which we all used to do before, it does not really strengthen the Nation, though it is very pleasant.

Machinery is very important.

New things that come out with a consequent new kind of machinery, for instance, for air services, and so forth, are more important than other things.

Then there is the question of, Do you grow in this sense, that you get more out per man-hour? That does not help the Nation, if then we cut the working week and we are back where we were.

So I would say that to determine a rate of growth, if you wanted to determine one, you first need a committee to sit down and say, What are we really talking about?

And, assuming they agreed on saying that growth—that gross national product is bad, but it is less bad than other things——

Representative CURTIS. It is a helpful statistic, but it has to be analyzed.

Mr. SONNE. It has to be analyzed.

Representative CURTIS. To have any real meaning?

Mr. SONNE. Then you have to say, What is a sensible rate of growth? And then I happen to come out at about 4½ percent.

Representative CURTIS. Of gross national product?

Mr. SONNE. Of gross national product.

But I do that from the angle that a much larger percentage of the growth will come in under what I call public expenditures. As you know, at the present moment the private sector spends about 70 percent and the Government 30 percent, if you take in social security and so forth.

Now, I say, just as a temporary goal, that the Government should take, of the increase in growth over and above that, about 40 percent, because I feel so very definitely that Congress will want to stimulate those things that strengthen this Nation.

Representative CURTIS. I am surprised to hear you say that, because what you are doing is substituting bureaucratic decision, and I do not use that as an epithet but as a descriptive term of a group of fine people, but you are substituting a political, bureaucratic decision in lieu of that of the marketplace.

I do not share your faith in the wisdom of any political bureaucracy, no matter how fine you might set it up. To the extent, perhaps, that Congress reflects the pressures of our people, and that gets into bureaucratic decision, and it does, possibly that would be wise, but I question it.

I could certainly direct attention to it. I think this is an area for political scientists to begin to excercise a little study and brainpower which they have not been doing. But I think this is in error.

There is nothing magic about Government. We are talking about human beings, and I do not happen to see why a human being, operating in a political bureaucracy, becomes wiser than human beings operating in the private sector, utilizing the marketplace as a test of decision.

In fact, in my judgment, if there has been a slowdown in growth in this country—and I do not happen to think there has been because I do not think we have been measuring what is really meaningful growth—but if there has, I would be inclined to think that it is because the one-third is too high; that we have been usurping decisions through the political structure that would be more wisely made if we would perfect the marketplace mechanism.

And, indeed, it needs perfecting, in my judgment; as an example, the antitrust laws which you have mentioned.

The SEC regulations, in my judgment, are all directed to trying to perfect the private marketplace mechanism so that sound economic decisions can be made in the marketplace. But I wanted to bring out for discussion an area where I can see we disagree and then to go on to further discussion.

Mr. SONNE. May I answer this?

Representative CURTIS. Certainly.

Mr. SONNE. You see, at the present moment, it is approximately 30 percent and 70 percent, but the reason Government is approximately 30 percent is that approximately 8 percent goes to social security which nobody will deny must stay there.

Representative CURTIS. Well, not necessarily through the Government, but at least it is there. I will agree that that should be separated out; yes.

Mr. SONNE. Now, if I may, I can see your interest and it is a little difficult to explain what I have in mind.

The facts are, I agree with you entirely, that you do not want bureaucracy.

Now, what I have said here also in a footnote to the report:

In the coming decade, we are likely to see emerge a large-scale pattern of semiprivate, semipublic, new national programs to achieve national growth in those fields where it is lacking.

There, I had in mind urban renewal growth, building, and so forth. These will be run, as far as I can see, like the port authorities are run now: semipublic, semiprivate. There, you get the benefit of the world knowing that the Government thinks that this is fine, but of private enterprise running them and guaranteeing to the people that invest that this is good business.

Representative CURTIS. I appreciate that.

Mr. SONNE. That is the way I see the future lies.

Representative CURTIS. I want to throw in a little bit of dispute on semantics, although maybe it is more than that——

Mr. SONNE. And if I may answer your previous question.

Representative CURTIS. Most certainly.

Mr. SONNE. I can see that Your Honor and I are fighting the same thing. That is the Keynesians. If you want them to really hit the ceiling, then tell them that Keynes did not discover at all the Keynes' anticyclical theory. That was started in 1720, 200 years before Keynes by a Scotchman called John Law.

But, unfortunately, the British would not let him inflate, so he went to France and inflated there, and naturally went bust.

And, consequently, his books are written in French. And since the British never read anything except English, not 1 out of 100 knows it.

But if you want just to put them in their place, then you will find that we have had 250 years in which to consider the Keynesian methods and we have found them wanting.

And, finally, may I say in answer to your first question about what would happen if we did not have any debt——

Representative CURTIS. Could I develop a little bit? I will come back. My time is about up, but I would like to say this on one point that you did make in going back to our Government relationship versus private sector.

My dispute with you may be a matter of semantics, but it may have more depth. I do not regard the Government as a partner even of private enterprise.

I regard it as a servant, and I think that the Government should only function when the private sector, the individual people, call upon it to perform some service.

And I am very worried about the way this word "partner" has crept into our discussions on this economic area. I think the Government is the handmaiden, it is ancillary to the private sector.

I will come back when I get further time.

Senator PROXMIRE. Mr. Sonne, I, too, would like to say that I agree very much with what you say in your general critical and discriminating attitude toward fiscal and monetary policy. I am inclined to share that skepticism. I think it is very healthy and a real contribution.

I would like to start off my questioning by referring to your statement.

I am not sure whether you are facetious or whether you are just using a little rhetoric here to tease us a bit or whether you really mean it.

You say in discussing monetary policy:

> The reason is, once we start to interfere with interest rates and natural market conditions, one interference is apt to result in some imbalance elsewhere which then, in turn, needs correction. You must remember that wrong ideas are apt to beget still worse ideas. They tend to chase right ideas out just as bad money chases good money out of circulation.

I presume by that that you are not arguing that we should not be willing to experiment, if our reason, our logic, discussion, develops in Congress and throughout the country that we think that a certain kind of monetary policy, however complicated and however it involves mixes, should be followed, that we should not be willing to follow the dictates of reason? You are familiar, I am sure, with Badgett's "Physics and Application," which is a very great and fundamental book on political thought and on economic thought.

I think the great thing that that contributes is that the real advantage we have in our system is that we do believe in discussion, we do believe in ideas and in the clash of ideas. And if an idea comes along and it is appealing and it survives in this competition of ideas, that we use it and we are not afraid to follow it.

Do I misinterpret—apparently I do misinterpret your position.

Mr. Sonne. Not at all.

I say, if you have wrong ideas—they start to check down here and suddenly they find the whole Federal Reserve System goes wrong in another Department, then you have to rectify that. By the time you go through one little thing that is a mistake, it needs rectification.

But let me say, if the Congress decides to do something, then it would not follow only that one course of action, because I say that one poor judgment leads to another; one mistake leads to another.

I would say in my naivete, perhaps, it is unthinkable that Congress makes mistakes.

Senator Proxmire. We have made many and we will make many in the future.

Mr. Sonne. I am thinking here mainly of the people who sit in the Federal Reserve who just love the open market operation. I mean I have been a trader myself. You get very keen. And they interfere far too often with the market.

Senator Proxmire. I would like to see them make some mistakes in a different way, though.

Would you not agree—maybe you disagree, I suppose you well might—that monetary policy is one instrument that we can use in our system of freedom?

Mr. Sonne. Yes.

Senator Proxmire. With a minimum of interference with the freedom of the individual.

Fiscal policy, on the other hand, involves real direct interference, because we have to increase his taxes; we have to interfere with the kind of activity in which he engages pretty directly and the kind of Government spending we engage in.

On the other hand, monetary policy is an area which we have traditionally engaged in for many, many years, and while it has an inter-

ference and limitation, of course, on the individual, it is far more general.

It is less confining.

I feel that if we are going to take any governmental action at all to stimulate our economy and provoke its growth, it must be through monetary policy, which means the Federal Reverve has to be willing to take it and they have to be willing to make decisions, and if you are going to make decisions, you have to be willing to take a chance on mistakes, occasionally, because if you are going to make decisions you are certainly going to make some mistakes, and not be afraid to make those mistakes, but correct them as rapidly as you can.

What is the matter with that attitude toward the Federal Reserve?

Mr. SONNE. I would agree with that attitude. I would just say this. Monetary policy is good if it is not carried to excesses. That is one way of interfering with the market. But one of our troubles is that no sooner do we get this thing moving before the young gentlemen down there get cold feet and then they go the other way.

And then you find that low interest rates and everything goes up. Then we get scared and it goes too far, and what is the result? It is a very bad one. It pays you better nowadays not to do any work and just watch what the Federal Reserve does, because when they stimulate low money rates, you can safely buy your securities; up it goes, and immediately they create higher money rates, down goes security values. First of all it makes hothouse plants out of business.

They are being guided, so to speak, by the people in the Federal Reserve whether to do a thing or whether not to do a thing.

Secondly, it encourages speculation when those businessmen instead should do something constructive for the country. So I say, by all means, use it, but use it advisedly and not too often. The big things naturally must be done. But this idea of coming in one month and say now we are going to have lower rates because we think so-and-so, we are going to have a panic; and the next month we are going to have higher rates because we think you boys are going too far—is unfortunate—I would say leave the markets alone except where there are very serious threats.

It may interest you to know I had a talk with Adenauer. I happen to look after the refugees in Germany. He said, "I am amazed at you fellows in America. It seems to me the Government, the Congress, and the President, are talking all the time about what is going on with business. I do not think of business more than once in 6 months. I leave them alone, and I only come in when there is something really fundamental."

Now, there you have the two extremes, but I am just mentioning it to show what I have in mind.

Senator PROXMIRE. Something like Freeman's proposal of a regular increase in the money supply to match the increase in growth in the country and the gross national product so that the money supply does keep pace with our needs for financing a larger country with a greater population and higher income, but that the free market forces be allowed to make their own adjustments, which is a healthy adjustment.

There is a natural restraint in times of boom.

Mr. SONNE. That is right.

Senator PROXMIRE. And a natural stimulation that develops, even if the Federal Reserve Board does not act at all, in times of recession.

Then you would, I would assume, have generally a neutral monetary policy in this way?

Mr. SONNE. A little more freedom. I do not say we should not interfere at all, but I compare it with a mother who looks after her children. When the children are 4 or 5 years old, she does not call them back each time they go across a path. She says, "Let those fellows learn a little bit," and she is only there in emergencies to pull them back.

I am afraid that we are gradually making hothouse plants out of business. Mind you, I am a businessman myself, so I know what I am talking about there.

Everybody, before they decide anything, says, "If only we knew what the Federal Reserve would do." Now, the main, sound, long-term schemes that really help to increase productivity in the country, they are sound whether the interest rate is 2 percent or 4 percent or 5 percent.

The advantage of low interest rate is grossly exaggerated as compared with the advantage of sound judgment.

Senator PROXMIRE. All right, sir.

Now, you paint a gloomy picture, and you indicate all the costs that we have suffered from policies in the recent past.

You talk about the increase in the debt and the increase in the money supply, and so forth.

My question is this:

After all, do you not overlook the enormous progress that has been made in this country, the fact that we are way ahead of any other country in terms of standard of living, the fact that we have made enormous gains at the same time, the fact that, while we have had an increase in the price level as compared to most other countries, it has been relatively moderate?

We certainly have not been the leading country, by any means, in the devaluation of our currency.

That with all these shortcomings and costs that you point to, the American people are richer, better off now than ever before?

The one really serious domestic economic problem we have is unemployment, and in the last 6 months we have had price stability. Why do you feel that this is a situation so gloomy?

Mr. SONNE. I would say that we certainly have increased or improved, but the facts are that we are no longer the strongest nation militarily speaking.

We have had to spend a tremendous amount on armament, and I give us credit for having spent it. I include in our armament expenses our gifts or loans abroad, which, to my mind, is all the same thing, for safety.

Senator PROXMIRE. Certainly you would not argue that we are not the strongest military power because of our monetary policy?

Mr. SONNE. No, no.

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Senator PROXMIRE. This is because we are not a monolithic dictatorship which pours all of the resources of its people ruthlessly into a military machine.

Mr. SONNE. I say that we are now spending so much that we may, after some years, again go back and have the upper hand. But that is a detail.

What I mean is we have done well, but as a result over the last few years, as you know, we have or are on the verge of overdrawing our banking account, if I may use the phrase, which is that our gold reserve accumulated in good times after the First and Second World Wars is going.

So we have been eating up our fat and our reserves, and that is a danger.

It is a danger particularly because of the international situation. If we are going to have the free world rally around America, America must not alone have a strong Army, Navy, and so forth, but we must also be economically in good shape.

Senator PROXMIRE. Do we not have an infinite amount of fat compared to the Soviet Union in that we have such an enormous productive capacity that we are not using and much of the productive capacity we are using is for nonessentials?

We are producing automobiles which we could fairly readily convert to tanks, missiles, planes, and so forth. We have the fat and the Russians do not, it seems to me.

We do have these immense reserves which we showed in World War II. It would seem to me that this is one source of enormous potential strength that our country has, as compared to the Soviet Union.

Mr. SONNE. I wish I could be as pleased as you are. You see, I would like to draw your attention to the Second World War. We had the British fleet to protect us and give us time to use our machinery.

Senator PROXMIRE. That is true.

Mr. SONNE. I do not believe you will get that in the next war. So I think things are a little different.

Senator PROXMIRE. Senator Pell?

Senator PELL. Mr. Sonne, I would like first to express my personal appreciation and pleasure at such an old family friend as yourself being here in these circumstances.

Mr. SONNE. Thank you.

Senator PELL. I was wondering what your thinking was in the preparation of the report in connection with this general policy of Government control of credit as brought out by Senator Proxmire?

I notice on page 203 of the report of your Commission that Mr. Shuman objects quite strongly to the use of Government controls, credit, financing, and downpayment requirements. Would you say that you and he shared the same views in this regard; in other words, that you were a minority in the Commission, or that you reflected the general views?

Mr. SONNE. I would like to be quite sure. Are we speaking here about mortgages?

Senator PELL. Mortgages and the extension of that would be the downpayment.

Mr. SONNE. This is page 203?

Senator PELL. Yes, the footnote at the bottom of the page.

Mr. SONNE. There was discussion—I do not know whether on this point there was a discussion whether we should change the maximum rate. Is that what you have in mind?

Senator PELL. Whether you thought the Government was too much in the field of setting the rates?

Mr. SONNE. Yes, and I also think, for instance, that when it comes to mortgages, that the Government, if it does give "Fannie Mae," as we call it, credit, it might just as well push it, even if the rates are so high that the poor fellow has to pay a little more, because, otherwise, you have to stop building when interest rates get high.

The reason why some people like to keep a maximum rate on it is for anticyclical purposes. They want to say when rates are high, then the best thing is to save and not build houses, and there comes into play the two opposing views which are interesting, but which, I would say, is not a fundamental issue.

Senator PELL. But within the makeup of your Commission, would you say that the opinions were about evenly divided on this point?

Mr. SONNE. I would guess so. I think so.

Senator PELL. What would be your viewpoint on this legislation that is being considered that would call for public disclosure of the full interest rate, so that when some poor devil buys something on time and is, in fact, paying 30 percent per annum he will know that fact instead of thinking, because he is only paying 2½ percent a month, that it is a lot less?

Mr. SONNE. If you want my opinion, I think this selling of cars, washing machines, on these terms is absolutely disgraceful. It is completely, to my mind, taking advantage of the ignorant and uneducated people.

You and I would not buy a car without figuring out beforehand what this extra charge amounts to and coming to the conclusion it is 20 or 25 percent.

Ignorant people do not know better and they just say, "That is part of the charge."

Senator PELL. Mr. Barnum once said there is a "sucker born every minute," but I think we have adopted a sophisticated attitude now that the Government is supposed to prevent the exploitation of this fact.

Mr. SONNE. Yes.

I think that it is much more justified than the usury law that exists in certain States. The usury law stops them at 6 percent. Then they go around and just because they add certain commissions——

Senator PELL. Usury is 8 percent, is it not?

Mr. SONNE. In certain States, but, at any rate, you have a limit within reason, and then just by changing it and making it commissions and insurance, you get up to 20. So I am very glad that Congress is looking into that.

Senator PELL. The other more general question I have is: What single, general effort do you feel the government could make to increase the gross national product, if you had to make a choice between different areas of emphasis?

Mr. SONNE. The single one?

Senator PELL. Yes, sir.

Mr. SONNE. To my mind would be to recognize and go all out for growth.

Senator PELL. But how, in what way do we do that, what particular step?

Mr. SONNE. You have to imagine that you were a czar of the United States in doing something like that. I think I would say that I know Mr. Kennedy has started a young man's army to help us abroad, and I would start an older man's army to help growth.

Senator PELL. Theoretically——

Mr. SONNE. And I would get a commission together who are practical people. Those are the people who help growth, by drawing your attention to five or six of the big men in Japan, for example, a dozen Germans that sit together, it would be people like Du Pont some years ago, and if they sat together and said, "Listen, it is a question of life and death for our trade policy of the United States that we get growth," you would get action, and you would have a mixture of businessmen and Government.

Senator PELL. But would this not lead to a cartelization of our economy?

Mr. SONNE. You see, the reason you want Government in on it is that there are certain things where business would come and say, "Here, if we are going to do so-and-so, we have got to modify such-and-such an act."

Let me tell you, for instance, that in those countries where the Russians interfere, many of the European countries, businesses there have close cooperation with their Government because, otherwise, they would lose the business in those places where the Russians interfere.

We should do the same, and we should say, "Never mind such and such a law, where you clearly come and want to work with us and in this place because the Russians are trying to grab it."

Senator PELL. Is not what you are saying really that the Business Advisory Council, or a group of that sort, in your view, should be given greater economic powers?

Mr. SONNE. I have a horror of too many people. I like to see a maximum of five people from among business and then five people from among Government and have them sit down and really do some work.

Senator PELL. Because, as you know, the policy of this administration and what the President is dedicated to is just what you are saying. He emphasized that in the campaign and the administration is emphasizing it now, and the problem is: How do we achieve it?

Mr. SONNE. Mind you, I have every confidence in President Kennedy. He may be on the right track. If he is doing that, God bless him. He wants to do the right thing.

Senator PELL. He is trying to do it.

Mr. SONNE. But, of course, too many things are falling on the man's head just at one and the same time. We cannot help that.

Senator PELL. But, in essence, you think the problem could be solved by some sort of small business council with effective powers?

Mr. SONNE. That would sit behind the scenes and not sit officially with all kinds of press coming down; that would sit and talk together and get in well-informed Government people who can answer:

"Yes, we think we can do so and so; yes, we think we can get a law through," and then lay a plan. I call that Kennedy's old man's army to improve growth.

Senator PELL. That is all. Thank you.

Senator PROXMIRE. Mr. Curtis?

Representative CURTIS. This last note really worries me. As far as I can see, there is a fundamental difference in our philosophy.

I just do not happen to think there are these wise men in our society, whether they put on a hat of a political bureaucrat or an economic oligarchy. This is opposed to what I happen to favor, a system which gathers together the collective wisdom of the people in our society to try to produce situations in what I regard as the marketplace.

In the same way, in the political arena the Congress is set up to gather together this wisdom and apply it to the problems of the day.

I must say that I think it is a will-o'-the-wisp anytime to think that there are such wise men in our society or that there ever will be. There was one thing on page 15, and then I did want to let you answer a question on the debt which you wanted to do, but on page 15 of your statement I refer to another area. In No. 2, you say:

> That economic growth should be made the one major goal, because a sufficiently rapid rate of growth will make much less difficult the solution of the two other goals—a low level of unemployment and price stability.

It strikes me that the more rapid your economic growth, the more difficult becomes the problem of correction of technological unemployment, and, incidentally, the more difficult becomes the problem of price stability.

The thing that would make it easy is to have a sluggish economy that was going nowhere. Then you can have your full employment and you do not have to worry too much about price stability. It is the very growth and the rapidity of it that creates these frictions.

So I think that is just the opposite. I do say this, and this may be the context in which you are making this statement: That if you are growing rapidly, your ability to solve these very problems that you create can be more easily accomplished, but to say that the problems become easier would not be so. I do notice that you say:

> It would make less difficult the solution.

So maybe we do agree.

Do you agree that the problems are aggravated in the field of employment and price stability on the basis of rapid growth?

Mr. SONNE. If I may explain?

Representative CURTIS. Yes.

Mr. SONNE. Very shortly, I think I said at a certain stage that we can, at the same working week as we do now, produce today's output with a million and a half to 2 million less a year from now, which means that we have not only got to get growth to take care of those now employed, but also the section of those who are working today who will be unemployed next year.

Representative CURTIS. I want to direct your attention to the point I am trying to make so that we can see this area of agreement of disagreement.

The point I am making is that, as you grow, of course, what you are doing is making a lot of skills obsolete.

Mr. SONNE. That is right.

Representative CURTIS. Particularly, you are making the unskilled and the semiskilled more useless. So the more rapid you grow, the more obsolescence of skills, so the problem is aggravated. That is what I am trying to direct your attention to.

Mr. SONNE. In other words, my point was that we have not grown yet. I have said we have got to find something. We have got to find employment, not alone for the unemployed, but for about a million and a half of today's workers. Therefore, we have got to give them more work to do.

Representative CURTIS. What kind of work?

Mr. SONNE. I want them to go out and dig and I want them to go out and help with the urban renewal and build roads, hospitals, and so forth.

Representative CURTIS. You do not want to have them make work. Make-work is not real economic advancement; is it?

Mr. SONNE. Which work?

Representative CURTIS. Make-work, where a bureaucracy says——

Mr. SONNE. No; not a bureaucracy; no.

Representative CURTIS. What jobs, that is the key to this thing? What are the things that you are going to have them do, that is the problem?

Mr. SONNE. Let me make it clear. For instance, just one point which I mentioned, urban renewal. If you got the proper urban renewal, including transport, transportation, that would be a very productive asset. The amount of hundreds of millions of dollars which we waste because of the goods which go down to the steamers and to the market and are congested, and so forth, and so forth, it is just fantastic. So that a number of those things that we want to do in the way of improvement will contribute to actually improve our trade balance, if you give them a couple of years' time and not right away.

Therefore, I say that it is much safer to assume that if you grow, then you would increase employment, then you would increase employment if you increase the demand, because you may increase a demand in certain ways which do not necessarily help employment. That is why I say "growth," to my mind, is the most direct way of assuring that it will go right into more jobs.

Representative CURTIS. I am afraid, though, you have got yourself in a semantic trap. I think you are just defining your own definitions and the solution is on the basis of that, and you are avoiding the real problem.

The real problem is, What constitutes growth? When you ask specifically how you define it and what it is, what men will do, which is the key to this thing, as I see it——

Senator PROXMIRE. Will the Congressman yield at that point?

Representative CURTIS. Certainly.

Senator PROXMIRE. Is it not true, Mr. Sonne, in countries like West Germany and other countries where you have got enormously rapid growth, you not only have no unemployment problem, you have a shortage of labor?

The country is growing so rapidly, its industrial plant, its whole operation is moving ahead so rapidly that you need more people to do the job.

So the notion that growth necessarily means more problems of unemployment certainly is not indicated in that particular model; is that not correct?

Mr. SONNE. It is interesting that in Germany, in spite of over 10 million refugees, they imported 500,000 foreign laborers from Spain, Italy, and Greece.

Senator PROXMIRE. And it is growing?

Mr. SONNE. And the southern Italians, which were supposed to be a little in line with our South in difficulties, would never get jobs in north Italy.

The Germans started a school and trained them for 3 months, these southern Italians from Sicily. They did very well with the result that the northern Italians began now for the first time to employ the southern Italians in their factories. But the Germans, in other words, have succeeded in getting a shortage of labor and importing labor. Why? I am not worried about the man that has to sit in an office——

Representative CURTIS. Let us stick, if we can, so we can follow through on the subject, I always like to have an example, and I think this is an interesting one, but would Germany have as high as 30 percent or one-third of the decisions made in the political bureaucracy and two-thirds in the private sector, or would it be 40/60, such as you are advocating here? I do not know what Germany's breakdown is.

Where are these decisions, these economic decisions, being made?

Mr. SONNE. They are made in their Parliament which is, in a sense, a copy of us.

Representative CURTIS. No, no; I am talking about the relation, the ratio of private sector to governmental.

Mr. SONNE. You see, the ratio in Germany is small because they have relatively a small army. You will remember they were forbidden an army.

Representative CURTIS. I do not care why. I am just trying to find out what the ratio is so that we can relate it to this problem. If we go rambling all over the subject, why, we would not remain on the point.

Do you know what the ratio is? I do not.

Mr. SONNE. No; but I would say it would be a bad country to pick because Germany is the one country that does not need to have an army. They have just begun now. The French, the Americans, and the English occupied them.

Representative CURTIS. We are using a lot of our people who could be otherwise employed in the Army. That is one way of taking care of unemployment. That is the way it was solved in the Korean war.

Mr. SONNE. Certainly that is one of the reasons why Germany recovered so quickly: That it did not have that additional burden.

Representative CURTIS. At least you say that it is not related to it.

Mr. SONNE. But I would say that if you had growth, you want to get the laborers to go out and dig, use bulldozers, you want to have more bulldozers, you want to build more hospitals, you want to get machinery renewed, and I think you get fundamentally down to really strengthening the base of this country.

Representative CURTIS. I still say I think you are answering the question with your own definitions rather than grappling with the real problem which is, what you are going to have men do and what system you are going to establish whereby these economic decisions are made.

I myself happen to think that the Federal Government in many ways is impeding economic growth, and, far from asking it to start making more economic decisions, I think if it would get out of some of this, we would have a lot more intelligent decisions made that we actually would be encouraging growth.

I again say many decisions in the political arena have been disrupting and disturbing what would be a more rapid rate of growth.

Mr. SONNE. I would agree with you that the less they do, the better, but we have seen the practice that this modern society government has to do something because private enterprise, for instance, cannot start waterworks, it cannot start things like that any more.

Representative CURTIS. Why not?

Listen, in St. Louis County it is a private water company and right next door in St. Louis City it is public, and anyone who will examine the two operations will see the difference.

That is an example of the ineffectiveness of a political bureaucracy trying to do something that is better suited for a series of economic decisions made outside of the political arena.

We are in politics because we are elected. Our talents theoretically are not in the line of making these kinds of day-to-day economic decisions.

If we have talents, I think they should be directed along the lines of political science. And, yet, this system you are suggesting is that the board of aldermen and the mayors can run a waterplant better than people in the private sector.

Mr. SONNE. Oh, no.

In New York we had plenty of water. The facts were some years ago that if New York were to grow 10 or 15 years from now there would be a shortage. So they had to make an additional dam in the Catskills that would cost many millions. Would you expect private enterprise to do that on the gamble that New York would grow? In other words, there are certain things nowadays where Government has to go in.

Representative CURTIS. Let me give you St. Louis County. There were 100,000 people and it is now over 600,000 in the period of less than 20 years, and all of this growth was anticipated and taken care of through the private sector so far as water is concerned.

Mr. SONNE. Let me say that you got revenue right away from water you sold, but these people who would have to put in the extra plant

would not get any revenue for 15 years and then only if New York grew.

I mention that merely as an incident that there are certain cases where the government has to step in. I would like the Government to stay out of details except to say, for example, "This question of arranging for urban renewal and for improved communications, and so forth, is taken over by such and such a type of organization, which is between private and public property." We would have a good start if the running of it was left to businessmen. That I would not mind.

But when they begin to interfere with it in the details, then I say we bring more bureaucracy in it. I hope we can compromise that.

Senator PROXMIRE. I am inclined to sympathize with the viewpoint which has been ably expressed for a long time by Congressman Curtis that we ought to keep the role of government in our free system as limited as we possibly humanly can, not only from the economic standpoint, but from a social standpoint, and from the standpoint that freedom means something.

But I cannot resist referring to an article by Ed Dale, who is a distinguished correspondent for the New York Times, in the New Republic, which is entitled "Confessions of a Conservative."

Mr. Dale was a very fine reporter and very competent economist, and he says that his experience in Europe discloses to him that if a country wants to solve its problems, it ought to encourage the Government to get into the problem of spending and so forth, involve itself in the economy as much as it can, and what he does is to cite West Germany as the prime example of this.

He says that they have vastly increased their participation in the economic activity, and it has resulted in enormous prosperity for the people.

They have a social welfare program which is very generous, in view of their limited standard of living. I must say that this is disturbing to me, but it is a fact that I think is pretty hard to refute.

I do say one more thing on this. I do think that Dale does not indicate that you do this by deficit financing. They have a balanced budget and then some in West Germany, but they have done it by an extension of the Federal Government into activity.

Mr. SONNE. Have you noticed that the Germans who go into these things, they support it, but they do not run it. They let business run it. That is where the Germans are very smart and that is what I want to do here.

Senator PROXMIRE. I would like to ask one final question. I have had an opportunity to go over only very briefly your supplementary statement which was handed to me. You have a very fine and very stimulating analysis, but your specific proposals are in this supplementary statement as to what we can do.

Mr. SONNE. That is right.

Senator PROXMIRE. In view of the very great unemployment and the need that you so well underline for growth, frankly, Mr. Sonne, I am somewhat concerned because your solutions seem to be return to the gold standard, is that correct, No. 1, and a reduction in the holdings of the Federal Reserve, which you feel owns too much of Government securities now, which you think is inflationary.

You feel if they dispose of these gradually and we go on the gold standard, that we could solve our unemployment problem and our growth problem.

I do not follow how that could give us the drive, initiative, and so forth to move us ahead.

Mr. SONNE. Let me first make it clear I do not say that we should go on the gold standard. There is nothing in there about that. I consider the gold problem rather——.

Senator PROXMIRE. I am glad to hear that. This was a summary that was just given to me offhand.

Mr. SONNE. Not from me.

Senator PROXMIRE. I am glad to hear that.

Mr. SONNE. Everybody talks about it as if it was so important. It is rather unimportant except we have got to be prepared to pay our bills.

It is more important that we have our international balance of trade in shape. Gold will have to be solved some years from now, and I do not think we should waste time on it now.

I do not even care whether Congress takes that 25 percent away or not. We have got to pay our bills abroad anyhow. To my mind, it is completely immaterial whether you leave things as they are or cancel that old bill.

I do say, however, that the second, the reduction, that is an expediency. We want in this country to have growth in my view in order to solve the unemployment problem. What is going to be the general feeling, the general opinion all over the world when we start really growing and go out, I mean definitely, to create growth?

They will say:

"Now the dollar is going to hell" and everybody will withdraw their balances. So the art is to find one thing that will make those guys realize that the dollar is stronger than ever, and if anybody can find anything better than the thing I have proposed, I shall accept it.

But that is the key, and if people all over the world know that the policy of the United States is to gradually reduce the bonds that are used to debase our currency, if they realize that is gradually being reduced, you only need to do that for 1 or 2 years and the world will say:

"So, now we know that the Americans are at last doing something sound."

That is the underlying idea, but I have a perfectly open mind on finding something better.

Senator PROXMIRE. That opens a very intriguing area, but there is a rollcall and I have to run. I apologize. I want to thank you very much for a very excellent presentation. The committee will reconvene at 2 o'clock.

(Whereupon, at 12:30 p.m., the hearing was adjourned, to reconvene at 2 p.m.)

AFTERNOON SESSION

Chairman PATMAN (presiding). The committee will please come to order.

Professor Wallich, I believe, is our first witness this afternoon.
Will you come around, please, Professor Wallich? Thank you, sir.
Professor Wallich, of Yale University. We are glad to have you, sir. I believe you have prepared a statement which you may use in any way that you desire.
You may proceed, sir.

STATEMENT OF HENRY C. WALLICH, PROFESSOR OF ECONOMICS, YALE UNIVERSITY; MEMBER OF THE PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS, 1959–60; AND CHIEF OF THE FOREIGN RESEARCH DIVISION, FEDERAL RESERVE BANK OF NEW YORK, 1946–51

Mr. WALLICH. Mr. Chairman, perhaps it is simplest and most saving of the committee's time if I summarize my statement.
Chairman PATMAN. Certainly.
You may insert it at the end of your remarks, and then summarize it from there, if you please.
Mr. WALLICH. Thank you, Mr. Chairman.
I am most appreciative of this opportunity to comment on what I think has been a good and thoughtful job done by the Commission.
Everybody will find some fault with it. I think, all things considered, it is a very constructive piece. I am to comment here on three subjects: The economic goals, the choice and combination of policy instruments, and the organization and coordination for national economic goals.
So, beginning with the goals, this is what I would like to say: The Commission sets up three principal goals, reasonable price stability, low levels of unemployment, and economic growth. It has some subsidiary goals such as harmonious foreign relationships, but these are the three principal ones.
The Commission thinks that basically all three are compatible, but it does see a conflict between low levels of unemployment and reasonable price stability, which is a familiar position. I think most economists would agree with it.
Now, one goal that I miss here is balance-of-payments equilibrium. I grant that our present deficit may be a temporary thing, and that there have been times when we did not have balance-of-payments equilibrium to worry much about. Nevertheless, at the present time I think this is so urgent and so fundamental to the health of the dollar that I wish the Commission had put that in. In Europe at the present time when experts get together, as they recently did for the OEEC, now the OECD, they list balance-of-payments equilibrium as a major goal.
A certain point that strikes one, as one looks at these three goals, is how they differ from the goals of the Employment Act, with which this committee is particularly concerned.
You remember, maximum employment, production, and purchasing power are our principal goals there. With a little good will one can construe maximum production as growth and maximum purchasing power as referring to reasonable price stability, and that, I think, is how it has been done.

But it is remarkable that at least in a literal sense, over a period of 15 years, two of the goals of the Employment Act seem to have been superseded in the view of the Commission by other goals. This should warn us, it seems to me, not to box ourselves in too firmly and attach ourselves too permanently to particular goals. It is clear that the Nation's needs shift from time to time and we have to keep on the lookout for new possibilities and new needs.

The Commission has resisted the temptation to name a growth target, over the protest of some of the footnoters, notably Mr. Stanley Ruttenberg.

I think the Commission has been wise for the simple reason that we do not know how much of any given policy it takes to produce how much growth. We do know what policies are helpful for growth; by and large, I think one can say that.

But we do not know whether half a percent reduction in the interest rate or a tax reform that reduces some brackets by *x* billions has an effect of increasing the rate of growth by an eighth of 1 percent or a quarter or one-half.

So, as long as we do not know what it takes, it does not seem to me that it makes a great deal of sense to insist that we are going to get a certain result. We ought to do what we can. We can do a lot more than we are doing. We should observe what comes out of it. If that is not adequate, then we should do more.

I have some doubts, also, about the Commission's employment goal. Commonly it is said 4 percent is an acceptable level of unemployment. Personally, I do not think that any rate of unemployment ought to be called acceptable, because the people who are unemployed certainly do not feel that way about it. So long as there is any possibility to improve the situation, I would suggest that we keep improving it. It very much depends on the structure of unemployment.

If the unemployment is, in part, in depressed areas or in particular age or occupational brackets, then it is much harder to do something about it in the short run. If it is evenly distributed across the labor force, it is much easier to do something about it.

Hence, I would not accept the 4 percent. However, the Commission does not even use the 4 percent as a goal, although it refers to it frequently. It says that the number of job vacancies should be the same as the number of job seekers. Now, we have no statistics on this, so we cannot really say what it means, what is the number of job vacancies.

I would think that if at 4 percent, which means roughly 2.8 million unemployed, we had 2.8 million job vacancies, there would be a demand for labor that would rapidly reduce unemployment and would send wages and prices going up at a very fast clip. I cannot imagine that the Commission thought this out properly.

Turning to the goal of reasonable price stability in the domestic sphere, I think one can argue a great deal about how bad inflation is. It is hard to prove anything. But we know today that regardless of its domestic effects, the international effects are very serious, because they cause the balance-of-payments deficit and the gold outflow, and they threaten the dollar.

The Commission accepts this. The Commission also accepts that part of the inflationary trouble is cost-push, resulting both from business use of market power and from labor use of market power. But they do not come up with any remedy. It is fair to say nobody else has come up with a conclusive remedy. But in Europe they are moving toward what they call a wages policy. The OEEC committee to which I referred a minute ago proposed that a government should at least know what rate of wage increases it thinks is tolerable in the light of productivity gains.

Productivity gains in this country have been for many years a broad average of around 2 percent. This is a figure with which one can quarrel, can introduce refinements, but still, when one looks at a recent National Bureau publication, 2 percent is not a bad figure.

My suggestion is that we ought to elevate it into a kind of voluntary drive, trying to keep wage increases at 2 percent, and putting pressure not to exceed that. In order to make this acceptable to labor, business would have to be under equal pressure to reduce its prices wherever productivity grows fast enough so that a 2-percent wage increase causes business profit margins to widen.

Otherwise, it would be manifestly unfair.

I think this could be done by antitrust policy, by the kind of efforts that Senator Kefauver has been pursuing. This combined two-prong drive, trying to keep wage increases at 2 percent, and putting pressure on business to reduce prices wherever productivity grows faster than 2 percent, will, after a while, get us to a slower rate of wage increase and perhaps to price stability. At present, we are increasing wages at 3.5 percent per year, roughly. Productivity goes up at 2 percent. It is inevitable, under such conditions, that over the years prices would creep up at 1.5 percent.

Senator DOUGLAS. Mr. Wallich, is that productivity per worker or productivity per man-hour?

Mr. WALLICH. Senator Douglas, it is per worker.

Senator DOUGLAS. Per man-hour it would be something more than that, would it not?

Mr. WALLICH. About 2.3 percent.

However, as you know, there is a considerable spectrum of these figures. The National Bureau people have worked out various approaches, including government, where productivity hardly rises at all, or excluding government. My figure eliminates the efforts of interindustry shifts. And it also includes government.

Senator DOUGLAS. Insofar as manufacturing and processing are concerned, have we not had in recent years also a decline in the prices of raw materials, so that the value added per unit of manufacturing has been even greater than a 2.3 increase in physical productivity per man-hour?

Mr. WALLICH. That is certainly true, that prices of raw materials have come down; and that has helped us. Now, over the years, I assume that one cannot count on this, and certainly, we do not want Latin America and other countries to have continually falling prices.

I would like to take the 2-percent figure as a basis principally also for this reason, Senator Douglas. Labor is not disadvantaged by having a lower money wage increase, if it means a correspondingly greater price decline. The increase in real wages is always the

same if competition functions adequately, if antitrust is pursued aggressively, and if there is real pressure to reduce prices wherever they can be reduced. I think what we need is a public campaign. Only the Government can initiate it.

This should have nothing at all to do with price control or with price hearings. On the contrary, it is designed to forestall these. I fear that unless we get to a sustainable rate of wage increases, we will be forced into more mandatory techniques.

Now, it is argued that if you establish a 2-percent wage increase standard, this would reduce the mobility of labor, and industries that need labor can no longer attract it by paying higher wages.

Well, this is true in the abstract. But the fact today is that the industries that are paying the highest wages, steel, for instance, or the auto industry, are the industries that least need to attract labor.

They need, if anything, to displace labor because they have unemployment. So the mobility mechanism works badly even now, and the modest proposal I am making will not worsen it.

It is also said that if productivity and wage increases are kept in step, this keeps labor from increasing its share in the national income. Again, this is true in the abstract. Actually, nobody will expect that this standard is followed absolutely and to the letter, nor would I expect it to be followed over a long period of years.

But for a few years, to limit ourselves to this 2 percent, I think, is helpful. When you look at other countries, like the United Kingdom, where they have now put a positive wage stop, a freeze on public employees in nationalized industries, you can see what we are up against competitively.

Now, I turn to the next subject. That is the choice and combination of policy instruments. One of the principal, I think, intellectual discoveries in the last few years is the idea that by having lower interest rates and tighter budgets, including a budget surplus, we can make more headway toward economic growth than by having the opposite; that is, tighter money and looser budgets.

And I might point out that this thought is due to Professor Samuelson who expressed it here before this committee some years ago.

I think the policies of the last few years have been broadly oriented toward the effort to achieve a surplus as a means of taking the pressure off monetary policy and reducing the need to keep interest rates high in order to restrain overexpansion.

Senator DOUGLAS. Mr. Wallich, your last statement interests me very much.

You say that there was an effort during these last few years to put debt reduction ahead of tax reduction?

Mr. WALLICH. Yes, sir.

Senator DOUGLAS. And to ease the pressure upon monetary policy. Do you regard these efforts as having been successful?

Mr. WALLICH. I think they have been moderately successful. I think if the opposite policy had been pursued, if the same degree of restraint, let us say, had been pursued by a looser budget and tighter money, the economy would have fared worse.

Senator DOUGLAS. But I mean the national debt increased during this period. In 1958–1959, the deficit was at a peacetime high, some $12.4 billion. I do not see that a debt reduction was put into effect.

On the contrary, the Federal Reserve Board certainly did not pursue an expansionist policy. It pursued a restricted policy. I wonder if you are not mistaking conversation for effort, or effort for achievement.

Chairman PATMAN. May I invite your attention to the fact that the debt limit was raised every year from 1953, I believe that is correct, is it not?

Mr. WALLICH. The period to which I am referring, which is the one in which I had practical experience in Washington, comes a little after this.

I think it is fair to say that during the middle fifties there was a feeling that tax reduction should come before debt reduction; that that would be more helpful in stimulating economic growth. This feeling, I think, shifted as time went on, so that by 1959–60, it was rather broadly felt that debt reduction should come before tax reduction.

Now, it is true that no very large debt reduction resulted, but at least an effort was made at it, and we were, to some extent, successful in preventing repetitions of these very large deficits.

Senator DOUGLAS. In 1954, we had a big tax reduction. In 1958–59, fiscal 1959, we had a big deficit, and that was not a budget surplus but quite the contrary, and the Reserve Board followed a tight credit policy.

The figures on page 31 of the economic indicators show the public debt at the end of the various periods, I quote to the nearest billion, 273 billion for fiscal 1956; 271 for fiscal 1957; 276 for fiscal 1958; 285 for fiscal 1959; 286.5 for fiscal 1960; 289 for fiscal 1961.

So that I think you are describing a feeling and not a real effort, and certainly not an achievement.

Mr. WALLICH. Referring to the 1954 tax cut in that recession, in the 1958 recession there was no tax cut.

Senator DOUGLAS. That is correct.

Mr. WALLICH. And I think perhaps it is fair to say that this is some reflection of that feeling, that the revenue ought to be——

Senator DOUGLAS. Certainly there was no debt reduction.

Mr. WALLICH. There was no debt reduction. The debt went way up. In the next year, the budget was put very drastically into balance; from a cash deficit of, I believe 13 billion, it went to budget balance. That was a very major effort. These things have to be viewed in a relative sense, comparing them to what would have been the result under alternative policies.

Suppose there had been a tax cut in 1958. We would in that case have had a bigger deficit and a need for much tighter money.

Senator DOUGLAS. We might have had a more rapid recovery, an increased national income, and greater tax receipts.

Mr. WALLICH. It is conceivable, but I think on balance probably less than likely.

Senator DOUGLAS. Go ahead.

Mr. WALLICH. Now, continuing with this policy that I think ought to be our approach, that is, to generate savings through the budget and to generate surpluses when we can, so as to have a lower interest rate and more investment, we now face the question of ——

Senator JAVITS. Mr. Chairman, would the witness yield for a minute?

I have come especially to welcome the witness with whom I had lunch, and I just wanted to explain to the witness that we have to vote on the Senate floor, and I am sure we will do our utmost to get right back.

Mr. WALLICH. Thank you, Senator Javits.

The policy I am recommending of tighter budgets and easier money is made harder by the balance-of-payments deficit, because as money gets easier, there is a tendency to take the money to other countries where it earns a higher rate of return.

This is a fact, and it has to be recognized. The international situation is against this kind of policy. But I think we should nevertheless try to pursue it as much as we can. A means to that end is a strengthening of our balance of payments that will make us, to some extent, impervious to an out flow of funds.

If we did the opposite, we would find ourselves getting to the situation in which the United Kingdom was during the 1920's. They had a structural balance-of-payments deficit, a continuing tendency toward an outflow. As a result, they had to keep interest rates high all through that period, and as a further result of that, the United Kingdom had economic stagnation and unemployment.

This is the opposite of what we want. Therefore, we ought to get to a position where our balance of payments is strong enough so that we can have lower interest rates and a tighter budget that will create savings for investment and growth.

Very briefly commenting on what the implications of the Commission report are for economic stabilization policy, the Commission says roughly this:

As the economy seems to be going into a recession, we should first ease monetary policy, reschedule already authorized Government expenditures, accelerate contract placement, work on housing credit.

If the situation becomes one of evident recession, we should use a temporary tax cut. They are recommending that the President have power to make such cut, subject to the veto of the Congress and I feel that this is a good recommendation.

But they are not in favor of raising expenditures, because that is a very slow-working affair. It is a sad fact that both in the 1958 recession and in the recent very light one we have done exactly the opposite. We have not cut taxes, and with that I think I am broadly in agreement. But we have piled up very large expenditures, which have taken a long time to bear fruit.

Now, in the recent recession, there was some justification for raising expenditures. I think as a result of the growth of the tax base, we are now in a situation where tax revenues are large enough to balance the budget at a substantial level of unemployment, and if unemployment becomes low and GNP goes to the capacity maximum, we would have a very large surplus. I think that is more than the economy can absorb, and so either an increase in expenditures or a reduction in taxes was in order structurally.

But I am afraid that with this latest military increase, we may have oversot the mark, and I would have preferred to see us balance this increase with a tax increase.

Without that, I fear that we may again have some inflationary pressure. Gold may begin to flow. You are already seeing some

slight deterioration in the balance of payments, and that hamstrings everything we are trying to do.

Now, turning to my third and last topic the coordination of economic policy, I think the principal recommendation is one for a committee headed by the President. But before I come to that, I would like to touch on the recommendation for a joint mandate for the Council of Economic Advisers and the Federal Reserve to be followed as a policy guide.

It is certainly true that words that were written in the case of the Federal Reserve almost 50 years ago cannot be expected to be exactly applicable to our situation today, and even the mandate of the Council, as I said at the beginning, is no longer quite up to date.

On the other hand, I do not believe that Washington would be very different if these mandates were reworded. The agencies apply their mandates in a way that gives contemporary content to the old and venerable words. In that broadly interpreted sense, I think these old and venerable words are perfectly usable.

I am not in any way against changing the mandate. We know, however, from past experience, that the meaning of the words or their contents may change quite rapidly. Hence I would not expect a great deal from changing these words.

Possibly—I am not a good judge of that—it might affect the situation in the Congress if there were an explicit mandate, for instance, for reasonable price stability. It might strengthen the hand of those who want to promote price stability. That would be a gain, and I think in that case it would be worthwhile.

Turning now to policy coordination, I would like to note first of all, that the Commisssion has bypassed the one big suggestion that has been around for a number of years. That is the proposal for a kind of monetary or economic council of the Government that would embrace all the agencies, including the Federal Reserve.

There are many versions of this proposal.

Some would be statutory and would subject the Federal Reserve to specific control of the administration. Other versions would be more consultative.

In any case, the Commission has brushed this idea aside. The meaning of this decision really is that they have voted in favor of greater independence of the Fed.

The Commission goes into considerable detail as to how an informal nonstatutory form of coordination should proceed. I can only sympathize with the logical difficulties of constructing such a mechanism. Whatever one proposes seems to have disadvantages. My own modest experience taught me that the arrangements that existed were not perfect and that alternative arrangements probably will have their defects, too.

Incidentally, I might say that the statement in the Commission's report that the Advisory Board for Economic Growth and Stability (ABEGS) had been dormant recently is not quite accurate. The Board met every Wednesday afternoon, with the same composition as in earlier years, that is to say, generally at the Under Secretary level. In particular on the first Wednesday of each month we discussed in great detail the credit situation, and to those meetings the heads of the various Federal credit agencies were invited. I would not say that the Board was dormant.

What was done there, however, was coordination at what you might call the informational level. Nobody was coordinated by laying down the law, but members were informed of what others did, and something like a consensus of the direction in which policies ought to move evolved. That, I would say, is the most elementary level of coordination. I think the proposal made in the Commission's report will produce this kind of coordination.

The next and more ambitious level of coordination is one where two or more agencies have to agree on a common action. The most important of those areas is what the Treasury and Federal Reserve do about the handling of the market for Government securities. Whereas in the informational type of meeting it is perfectly useful and proper to have a room full of people, I think when agencies have to thrash out their operational problems, the fewer people in the room, the better. They speak more frankly. There are fewer crosscurrents, and business will be accomplished more effectively.

Therefore, I would not suggest that the kind of coordination that involves mainly information be thrown into the same committee that handles decisions on public debt offerings, open market operations, and so forth. In the past, and I believe now, this has been conducted principally between the Secretary of the Treasury and the Chairman of the Federal Reserve Board. Contact at the staff level has been frequent and intimate, and I am sure that this continues.

Here I would venture to suggest that instead of the large committee proposed by the Commission, it would be better to have a small group, and one that from time to time meets with the President, as I believe is happening now as it did in the past. It would be helpful to have the CEA Chairman in on this, so that there would be in effect four people. The job originally occupied by Dr. Hauge and subsequently by Dr. Paarlberg as Economic Assistant to the President, who participated in those meetings, would not be continued. If the President attends, there would be four in such a meeting, and I think sensitive business can be conducted there.

Finally, there is the kind of coordination where an agency has to be permitted or persuaded to take some particular action in its own particular field. This happened, for instance, in the NAC, when the Export-Import Bank or the Development Loan Fund or the ICA came in and said, "Shall we make this loan?" And there the very great difficulty arises that other agencies have to tell one agency what it ought to do or not to do. This is a delicate and sensitive matter. I think it has been helpful that the National Advisory Council is a statutory body, so that there was a statutory responsibility to arrive at a recommendation. If this had been an informal committee set up by Executive order, I think the NAC would have had less power of cohesion and power to ride herd.

I am not completely happy therefore with the Commission's recommendations that the NAC in effect be dissolved and made into an informal committee. There are many other aspects of coordination that have to be observed.

It is useless for instance, to assemble a large number of people in a room if the subject relates only to a few of them. That argues against the commissions big committee that would meet regularly on an agenda that often would have to be highly selective.

Likewise, it is useless to seek to engage the attention of top level people if the agenda on a particular day is of no great interest. They will not come. They send their deputies, and before one knows it, the committee has somehow been downgraded. In the ABEGS, as it was run in the old previous administration, an effort was made to avoid to have substitutes and to have the Under Secretaries themselves attend.

Finally, the Commission's tendency to throw everything into committees is likely, to undermine the Cabinet itself. National security business is already in the National Security Council. If economic matters are likewise thrown into a Cabinet committee what is going to be left for the Cabinet In effect, there is a danger that the only Department heads not involved would be the Postmaster General and, in some other administration, the Attorney General. The Cabinet would be hollowed out.

Again I do not have any obvious alternative solutions, but I think these things ought to be considered before a stamp of approval is put on the Commission's coordination proposals.

Finally, in talking about committees, we are talking basically about procedure. This neatens up things, assures smoother operation and is highly important. But it involves also a matter of substance, because in setting up a coordinative committee, a decision is made implicitly who is going to be the coordinator.

For example it seems very clear that coordination of the Fed does not just mean smoother operation. It means the Federal Reserve is subjected to a different policy control. All experience that we have had so far shows the overwhelming probability that when there is not complete agreement between the Fed and the administration, the softer line will be that taken by the administration and the harder line that taken by the Fed.

Hence one's inclination toward coordination or no coordination of the Fed basically ought to depend on one's monetary philosophy. If, on balance, one is for the softer line, one will be for coordination. If on balance one thinks that the harder line is preferable, one will throw one's lot with the Fed and against coordination.

This, I think, is the real substance of the matter, as contrasted with the procedural aspects. The same thing happens with the Federal lending agencies. Here are agency heads doing an excellent and devoted job. They have their circle of customers and they are trying to service them. They are quite naturally expansionists. From their point of view that is what they ought to be. But from an overall point of view, there are times when the Federal lending agencies ought to expand, and there are other times when they ought not to expand.

Now, if they are coordinated, it is clear that the expansionary force will, at certain times, be reduced. Furthermore, much depends on who coordinates. If they are coordinated under the Secretary of the Treasury, as the Commission proposes, we will have a different result from what would happen if, for argument's sake, they were coordinated under the Chairman of the CEA. I would venture to guess that in most cases, coordination under the Secretary of the Treasury will mean a harder and less expansive line than coordination under the Chairman of the Council of Economic Advisers.

Finally, we must look at coordination in the international field. It is desperately important because of our balance-of-payments situation. We have had in the past the National Advisory Council, which dealt with financial matters, and the Council on Foreign Economic Policies which dealt with general economic matters. The CFEP has been abolished and its principal functions have been thrown into the State Department.

For that no doubt there are a good many reasons. But what it means is that an agency which has a minimum of interest in restrictive policies is now the principal coordinator of those activities. Meanwhile the Commission proposes that the NAC also be in effect abolished, and that its functions be put into a subcommittee of the big economic policy committee. I would venture to say that if that were done, the hardness, the restrictiveness of the international policy line would be much less contrasted with what it would be if the Treasury—and I am sure this applies to any Secretary of the Treasury—continues to chair the National Advisory Council.

This would be true under any administration, and it poses a dilemma. We have got the very serious problem of the balance of payments, which counsels restraint. We have got the serious problem of a world that threatens to break away from us, and foreign aid is one of the means that we have to keep it on our side.

We have to be generous and farseeing in our international policies, but we must also be prudent. These two things need to be balanced against each other. I would urge that, whatever organizational solution is adopted our farsighted and generous foreign aid be matched by appropriate policies to strengthen the balance of payments, including tax increases.

In conclusion, and with reference to the Commission's plea for better statistics, I would like to refer to a new census report, which has been in the course of development since late 1957, when the 1957–58 recession got underway. It has been produced by Dr. Julius Shiskin of the Bureau of the Census and is based on the National Bureau's leading indicators. These leading indicators have become quite widely known recently. The new census report is an elaboration. We have about 30 leading series in it instead of just 8 or 10, and there are 15 coincident series. There is a considerable amount of analytical material, diffusion indexes, and different ways of putting the data together.

The Commission says that we ought to have a better reporting system and we ought to improve the Economic Indicators which the Council publishes for this committee. I am all in favor of this. As a matter of fact, last year there was a big effort by the CEA jointly with the staff of this committee to improve Economic Indicators, and I hope that you are reasonably satisfied with the job that was done. This new census job, is different, in many respects, because it classifies many of the same series according to their cyclical properties, leading, coincident, or lagging. These are not always assured. Sometimes the series that usually lead do not lead. But they are helpful, and I think they meet, to some extent, the demand of the Commission for improved statistical procedures. It is expected that, within a few months, this report will begin to be published monthly.

Thank you, Mr. Chairman.

(The entire statement of Mr. Wallich is as follows:)

STATEMENT ON ECONOMIC GOALS AND COORDINATION, BY PROF. HENRY C. WALLICH, YALE UNIVERSITY

This statement is submitted in comment on three chapters of the report of the Commission on Money and Credit: Chapter 2: "National Economic Goals"; Chapter 9: "Choice and Combination of Policy Instruments"; and Chapter 10: "Organization and Coordination for National Economic Goals."

The Commission, in my judgment, has done a good and thoughtful job. Its recommendations deserve the closest attention. In the following testimony I shall point up some of these recommendations. A good part of it, however, will inevitably deal with matters that I find more controversial.

A. NATIONAL ECONOMIC GOALS

The Commission singles out three central economic goals: (1) Reasonable price stability, (2) low levels of unemployment, and (3) economic growth. It believes that fundamentally all three are compatible. Nevertheless, it sees an important possibility of conflict between reasonable price stability and low unemployment.

(a) *Balance-of-payments equilibrium as a fourth goal*

The three goals that the Commission has chosen to label as central are of obvious importance, and little quarrel can be raised with their selection. Nevertheless, our recent experience suggests that reasonable equilibrium in our balance of payments deserves to be ranked as a major objective. If we fail to achieve it, we shall not only encounter difficulty in pursuing the Commission's three central goals. We shall also suffer serious setbacks in our other international economic and security objectives. If the Commission had added reasonable balance of payments equilibrium to its roster, it might have been led to place still greater stress upon the dangers of permitting even a mild further upcreep in prices.

(b) *Contrast with Employment Act goals*

It is worth noting that the Commission's goals coincide with those specified in the Employment Act—maximum employment, production, and purchasing power—only with respect to the employment goal. "Maximum production" and "maximum purchasing power," to be sure, can be interpreted to refer to growth and to price stability, respectively. To endow historic terms with fresh meaning taken from contemporary context is common and entirely proper in our experience. But it is obvious that when the Employment Act was drafted, the concept of "growth" was far less clearly seen, and that fear of unemployment greatly outweighed fear of inflation.

The rapid evolution of our goals, under the impact of a brief 15 years' experience, suggests caution in accepting new goals as definitive, however plausible they may appear. We must remain on the lookout for new possibilities and needs that may become important.

(c) *Omission of growth targetwise*

The Commission wisely resists the temptation to name a specific growth target. We have today a fair general idea of the factors that contribute to economic growth, but we cannot say how much added growth we can expect from stepping up any one of them. It would be futile to set a target not knowing what it would take to attain it. Our best plan is to act vigorously now for more rapid growth, and to observe the results. If they appear insufficient, action may have to be intensified.

(d) *Employment goal statistically dubious*

The Commission "believes that an appropriate target for low-level unemployment to use as a guide for monetary, credit, and fiscal measures is one somewhere near the point where the number of unfilled vacancies is about the same as the number of unemployed." Since there exists no central registration of job vacancies, the significance of this proposal is difficult to assess. A 4-percent unemployment rate, to be acceptable under the Commission's criterion, would imply close to 3 million job vacancies. It seems hard to believe that anything like that number existed at the various times when unemployment stood at 4 percent. More likely, equality of vacancies and unemployment would come about only at much lower levels of unemployment and would be accompanied by a vigorous rise in wages and prices.

(e) *No answer to cost plus inflation*

The Commission believes that prices have been driven up not only by excess demand, but recently to an increasing degree also by cost push, i.e., by the use of market power by business and labor. It has found no reliable remedy for cost-push inflation. The Commission recognizes that monetary, fiscal, and debt management policies can provide only a partial answer, because they work primarily by restraining demand. It mentions action to increase labor mobility, to reduce obstacles to greater efficiency, intensive antitrust policy, and foreign competition. But it does not argue that these can do the full job.

The basic facts are obvious. Productivity, over the long pull, has been advancing at an average rate of something like 2 percent. Wages are rising at about 3½ percent per year. As long as wage increases continue to exceed productivity gains, prices are bound to keep going up. With business once more on the rise, wage increases are more likely to become larger than smaller.

Labor is the victim of this condition along with the rest of the economy. A 3½-percent wage increase partly cancelled by a 1½-percent price rise is no better than a 2-percent wage increase at constant prices. Meanwhile, employment suffers because fiscal and monetary restraints must be used in the absence of means of dealing with cost-push inflation more directly.

The obvious remedy is for wage advances to stay within such limits that their average does not exceed long-term productivity gains. Nationwide productivity gains, rather than gains within an industry or a firm, must be the standard. Otherwise unreasonable differentials between industries or even firms would emerge.

Above-average wage increases for some unions would always be possible so long as there are others below average to compensate for them. In practice, the success of some unions in obtaining a high settlement becomes the reason for higher rather than lower settlements elsewhere. Pressure must therefore be bought against all increases that exceed long-term productivity gains. As a rough rule of thumb, I would suggest that 2 percent be regarded as the standard for noninflationary wage increases.

Firm observance of such a standard over long peroids of time might create rigidities and interfere with labor mobility. Over a few years, however, and in the loose form in which at best such a standard is likely to be observed, these distortions are practically negligible, compared with those generated by the high wage differentials already existing. Thanks to these differentials, the industries that are in least need of more labor usually pay the most attractive wages. For the short run, the proposed rule of thumb is quite workable.

Prices will have to come down in industries where productivity advances faster than the average. Otherwise these industries would experience increasing profit margins. Labor can scarcely be expected to moderate its wage demands unless a similar restraint is observed on the side of profits. The same applies with respect to executive salaries, stock options, and expense accounts.

Declining prices in industries with rapid productivity gains will make up for rising prices where productivity advances slowly, as in services. Because there will always be such price increases, mere stability elsewhere is not enough. There must be positive reductions.

The establishment of a 2-percent wage standard be entirely voluntary, although backed by strong pressures of public opinion mobilized by Government. Neither outright controls nor hearings are appropriate means of checking the movement of wages and prices. But unless we suceed in restraining these pressures by the voluntary means normal in our society, events of the next few years may well push us toward mandatory controls.

The Commission's Report recognizes the desirability of voluntary restraint on the part of business and labor. But so long as appeals of this kind are not backed by a positive standard of what is reasonable, they will carry little weight.

Adoption of a conscious wage policy by governments has recently been recommended by a majority of an OEEC group of experts. Viewed as a way of forestalling rather than of inviting outright controls, I believe this proposal is in line with what I have suggested.

B. THE CHOICE AND COMBINATION OF POLICY INSTRUMENTS

The Commission supplies an interesting chapter on the characteristic effects of particular policy instruments and the various ways in which they can be combined to achieve the goals it has set forth. The discussion deals with long-run policy mixes as well as the mix appropriate in different phases of business cycles. It recognizes the important constraint that the balance of payments places upon the use of lower interest rates, because of the danger of large outflows of capital.

The Commission is wise in not making detailed recommendations to meet hypothetical contingencies. This would have led to laborious casuistry. In the event, circumstances usually turn out differently. Nevertheless, some of the alternatives expounded invite comment.

(*a*) *Growth orientation*

The Commission points out that different mixes of fiscal and monetary stimulus or restraint will have different effects on economic growth. This is a proposition that was put forward before this committee some years ago by Prof. Paul Samuelson, who will be the concluding witness today. Monetary policy affects primarily investment, fiscal policy importantly affects consumption. A budget surplus coupled with low interest rates will exert the same degree of restraint or stimulation as a budget deficit coupled with high interest rates. But the tight budget-easy money combination will produce more growth than the tight money-easy budget team.

At some times in our experience, we have allowed ourselves to be pushed toward the less favorable combination, overusing monetary restraint and underusing fiscal restraint. The last few years saw an effort to get away from this mix, by putting debt reduction ahead of tax reduction, and by trying to achieve a budget surplus that would ease the pressure upon monetary policy.

(*b*) *Balance-of-payments constraint*

The emergence of a weak balance of payments, in a climate of convertible currencies, has made this tight budget-easier money policy more difficult to pursue. It is no longer possible to reduce interest rates regardless of the balance of payments and the international flow of capital. This fact must be accounted one further reason making balance of payments improvement urgent. We must on no account get ourselves into a position where we would have to keep interest rates high continually in order to attract international funds. That is the position in which the United Kingdom found itself during much of the 1920's, which accounted in part for the stagnation and unemployment suffered.

(*c*) *Are we following the right anticyclical policy?*

In a recession, the Commission argues, the inital steps should be a kind that can quickly be reversed if the economy proves merely to have faltered and not to have turned down. These include monetary easing, greater liquidity to be provided by public debt management, speeding up of Government contracting and of already programed expenditures, and easing of terms under Federal mortgage programs. If the decline becomes definite, a temporary tax cut becomes appropriate. In an earlier chapter, the Commission recommends a limited power for the President to make such temporary cuts subject to congressional veto, a proposal I would like to endorse.

The Commission's view that tax cuts rather than large and prolonged expenditure increases are best to cure recessions is interesting in view of the fact that in the last two recessions we have done the opposite. If the Commission is right, as I think it is, we are in danger of once more encountering inflationary pressures from the delayed effect of the expenditure buildup.

In our present situation, justification for a certain increase in expenditures can be found in the view, which I share, that the budget tended to come into balance at too low a level of GNP and employment. A structural change in the budget was appropriate, which could be made either by raising expenditures, or by cutting taxes. But a large sudden expenditure increase can overshoot the goal. It then holds out an inflationary threat. Moreover, it may inject a new momentum into expenditure trends that could be hard to brake in future years. Our last expenditure increase should, in my judgmeent be followed by a moderate tax increase to take effect at the beginning of calendar year 1962. Without this, I fear that inflationary pressure and a renewed gold flow may once more compel us to resort to higher interest rates than would otherwise be necessary.

C. ORGANIZATION AND COORDINATION FOR NATIONAL ECONOMIC GOALS

(a) *Commission proposals*

As guides to better decision making the Commission offers a number of useful proposals. It wants the Federal Reserve Act and the Employment Act to share an identical new mandate, couched in terms of low levels of unemployment, reasonable price stability, and economic growth; it wants the President to render quarterly reports when the economy is not doing well, and it wants to overhaul the Government's coordinating and decision making machine in the field of the National Advisory Council, the Federal lending agencies, and of overall growth and stabilization policy.

On balance, these proposals are probably to the good, but they are not likely to make Washington very different from what it is now. It is doubtful that the policies of the Federal Reserve, of the CEA, and of the administration generally have been significantly affected by the fact that events have made the wording of the mandate of the Federal Reserve completely and that of the Council partly out of date. And the rapidity with which this has happened, as said earlier, makes one doubt the permanence of any new set of goals. Likewise, it is debatable how much the President's policies will be affected by the obligation to render more frequent reports and explanations.

In the area of policy coordination, however, the Commission is conspicuous for what it does not do. For years, the principal proposal in the field has been for a National Economic or Monetary Council, which in greater or lesser degree would coordinate and subordinate the Federal Reserve. The Commission's ideas are far more modest. It prefers a largely nonstatutory solution, an informal committee structure that could be restructured by each President to suit his needs and work habits. Because of the complete flexibility of this approach, the precise arrangements proposed are not of primary significance. Important in setting up this kind of structure are, rather, certain facts and principles of Government procedure to which I would like to address myself.

(b) *Areas of coordination*

The legislative program of the President is coordinated by the Bureau of the Budget. Every Department must clear its proposals through the Bureau which obtains the reactions of other departments and agencies which it believes to be interested. If more extensive coordination is desirable, which I do not believe, the Budget Bureau could readily undertake it.

This leaves the areas of administrative policy and advance legislative planning which must be coordinated through other channels. In the financial field, these areas are principally monetary policy, public debt management, overall fiscal policy, and the activities of the Federal lending agencies. In addition, there are activities affecting the balance of payments. Though many of the latter, such as foreign aid, eventually take the form of budgetary and other legislative proposals, and so are coordinated through the Budget Bureau, advance planning here is so important that coordination becomes essential at the earliest possible stage.

(c) *Degrees and levels of coordination*

At a minimum, coordination must take the form of mutual information. Each agency should know the thinking and planning of others operating in related fields. Though differences of views and even of purpose may persist, they should at least be brought into the open. This applies, for instance, to the general policy objectives pursued by the Federal Reserve, the Treasury, and the Council of Economic Advisers.

The next and more desirable stage is coordination of different agency actions. For instance, open-market activities of the Federal Reserve and debt management operations of the Treasury must be brought into some degree of harmony. Ordinarily, this type of coordination will affect only two or three agencies on any one subject.

Finally, there is the kind of coordination which requires a group of agencies to agree on the operations to be conducted by any one of them. An example is the National Advisory Council, which must reach agreement, for instance, on loans to be made by the Export-Import Bank or the Development Loan Fund. Here the backing of a statute has proved helpful if not essential. The activities of the Federal lending agencies in the domestic field are essentially of the same type, but no high degree of coordination has been attempted. This is a step that ought to be taken on a nonstatutory basis.

Different phases of coordination suggest different hierarchical levels and different numbers of participants. Coordination of Federal lending activities should be possible well below the level of the President, barring unusual differences of opinion. The problems of the Treasury and Federal Reserve can best be handled between the two agencies, with perhaps the addition of the CEA. Occasional contact of this group with the President is desirable. Board budgetary and fiscal decisions necessarily must involve the President. In most instances, it is desirable to have the issues shaped up at the staff level, so that they can be carried up the line with a minimum need for further exploration.

The Commission's report analyzes some of the stresses and strains, the evasions and frustrations that the alternative mechanisms of coordination are likely to generate. Any choice here is bound to be a choice among lesser evils, including the evil of waste of time. The Commission's proposal for a Cabinet committee as the principal arbiter, meeting frequently with the President, suffers from the defect of undermining the Cabinet itself. With security matters in the National Security Council and economics in the proposed new committee, the Cabinet would have little business.

(*d*) *Coordination may bias policy*

The principal significance of coordination, however, is not the neatness of the table of organization nor the smoothness of operation that it achieves. It is the predictable bias that it is likely to impart to policy. In the case of coordination of the Federal Reserve, the issue is clear. In a difference of views with the administration, the Federal Reserve is likely to be for the harder and the administration for the softer policy. This is the lesson of past experience. An independent Federal Reserve is likely to mean a harder monetary policy, a coordinated Federal Reserve on balance a softer policy. Views for and against coordination thus are likely to reflect principally differences in monetary philosophy.

In the case of the Federal lending agencies, the issue is not quite so clear. But by and large, the natural tendency of the agencies is expansionary. Effective coordination on balance will tend to curb this expansion. It will make a difference, moreover, who is the principal coordinator. In most circumstances coordination by the Treasury, as proposed by the Commission, is likely to produce more restraint than coordination by the CEA.

The issue repeats itself in the balance-of-payments field. The fact that through the NAC, foreign lending activity was coordinated under the chairmanship of the Treasury has made policy different from what it would have been under the leadership of the State Department. The range of functions of the NAC, being limited to finance, is admittedly too narrow for comprehensive balance-of-payments guidance. The Commission wants to see the NAC in effect dissolved, the area of coordination broadened, the function located in a subcommittee of the Cabinet committee dealing with overall economic policy. This is a matter requiring the most careful thought. The state of our balance of payments demands caution, the state of the world demands the ready use of the dollar where its use can be decisive. What is clearly needed is a form of coordination that will produce action to balance the accounts whenever new commitments for foreign aid or foreign military expenditures must be assumed.

(*e*) *A new economic reporting system*

The Commission proposes that the collection of data bearing on the economic outlook be speeded up and intensified. It would like to see an improved version of the Economic Indicators, now prepared by the CEA for this committee, issued from the Executive Office. It may be worth mentioning that this activity has already been underway for some years in an experimental and therefore unpublished form. Since the 1957–58 recession, Dr. Julius Shiskin of the Bureau of the Census has prepared a monthly report of this kind for the CEA. It is based principally on the system of leading indicators developed by the National Bureau of Economic Research. This report comprises some 30 leading series, 15 coincident series, and 7 lagging series, many of them embracing a much larger number of subseries. The data are electronically processed, and in some instances it has been possible to accelerate the collection of the original data. As a result, the report is available usually before the 20th of each month with data covering the preceding month.

In addition to the data themselves, the report contains a considerable amount of analytical material. The various series are converted into so-called diffusion indexes, which show the proportion of rising and declining components. The data are not only adjusted for seasonal variation, but also for differences in amplitude of fluctuations. This permits better comparability and the averaging of series of widely different character. Comparisons with earlier business cycles are made.

During the last few months, this report has been circulated among economists for review and comment. While many changes and improvements no doubt are still ahead, its experimental period may be considered at an end. Funds have been appropriated for its continued preparation and for its publication. It should answer in good measure the Commission's request for improved statistical information.

Chairman PATMAN. Thank you, sir. I want to make a very brief comment and ask you a question, Professor Wallich, please. On page 6 of your statement you say this:

A budget surplus, coupled with low interest rates, will exert the same degree of restraint as a budget deficit coupled with high interest rates.

I believe that to be true. The pratical problem we face, though, is this, Professor: In recession time, the Federal Government runs a deficit and this is pretty much automatic because of the automatic stabilizers.

But when recovery starts, the Federal Reserve moves in first and raises interest rates before there is anything like complete recovery. In other words, the Federal Reserve gets there first ahead of the tax collector. Do you have any suggestions as to what we can do about this administrative problem?

Mr. WALLICH. I think your observation, Chairman Patman, is accurate as far as the appearance of the statistics goes. But I would like to point to two things. First, even if the Federal Reserve sat perfectly still and did nothing at all, interest rates would tend to rise as business expands, simply because, while the supply of money would be then fixed, the demand for it would be rising.

Secondly, while it looks as though our tax revenue situation was still quite bad, this is because we are looking at it in terms of cash collections. If you look at it in terms of the national income accounts, which allow for the accural of tax payments by the corporations and hopefully by the individuals who will have to report quarterly, the situation is a good deal better. In this sense the tax collector, I think, gets in there from the start, and revenues begin to rise.

What is certainly true is that we do not raise taxes. I am not arguing that, as a general matter, and the present defense situation aside, we ought to raise taxes as we come out of a recession. I would like to rely upon the general structure of the budget. I would like to see the budget so set that when we get the economy to high capacity operation, it produces a moderate surplus. In that case, it would produce balance somewhat below capacity and produce a sizable deficit if we should experience very low capacity and high unemployment.

If we adjust these factors correctly, that is, the level of expenditures and the rate of taxation, I think we will get what you are aiming at. The trick will be in setting the level of expenditures right and having the right level of taxes.

Senator PROXMIRE. In your statement, Mr. Wallich, you refer to getting statistics on the number of unfilled vacancies and indicate that this is a pretty vague and unsatisfactory goal to shoot at. We do not have statistics, we do not have available information on it.

This committee through the Subcommittee on Statistics is going to investigate unemployment statistics in December and try and see if we can come up with the fulfillment of the recommendations made on page 39 of the Commission report, in which they ask for a major study of the whole unemployment field to develop a lot more information than the kind we have. We hope that this subcommittee inquiry will determine whether or not that study can be made, the dimensions of it, and so forth.

I wonder if you had in mind in making this statement that this kind of major study referred to by the Commission on Money and Credit could give us some of the answers on unfilled vacanies, and, if it did so, if we knew how many unfilled vacancies there were, if this could be achieved—my first question is, could it be—if it could be, do you think that then we would have a significant basis for determining what would be a tolerable level of unemployment?

Mr. WALLICH. Senator Proxmire, I think it can be done, because the British do it. But they have a different system both of counting unemployment, as you know, and of dealing with job vacancies. Their system of counting unemployment is to make people register with the National Employment Service, whereas we have a household survey. And they also make employers register their vacanies.

Our system of counting unemployment shows a considerably larger number of unemployed. If we were to try to get businessmen to list their vacancies, which I think would be desirable, they ought to list their vacancies with the U.S. Employment Service. I am still not sure that we would get something comprehensive, though we might get something that is statistically commensurate with the way we obtain the unemployment figures.

Senator PROXMIRE. Can it be done on the sample basis? Could we do it on the basis that we get unemployment figures, recognizing we probably could not get a comprehensive listing from business of their vacancies? Could we take a cross section and explore this in some detail and come up with some estimate that would have some value?

Mr. WALLICH. I would be in favor of trying this on an experimental basis, maybe in a limited area, not publishing the data for quite a while until we had explored what they really mean and what are their weaknesses. I would be particularly concerned about the danger of duplications. If a businessman needs an employee, he might not list him just in one place. He will ask around and he might list him wherever there is a possibility. And we might think that we had millions of job opportunities that really didn't exist.

Senator PROXMIRE. At any rate, you feel even if we had these statistics, that what the Commission recommends would be a situation that would probably result in a very great pressure on prices. If we had unemployment at a low enough level so we had the number of unemployed about equal to the number of job vacancies, you feel that we would have considerable inflationary pressure; is that correct?

Mr. WALLICH. This is my opinion, unsupported by fact in the United States, because we simply have not got the data.

Senator PROXMIRE. So the price we have to pay for price stability is a certain amount of unemployment?

Mr. WALLICH. A certain amount, however low, is probably unavoidable. We will never get to zero. I think we can, if we improve our structural situation, do a lot better than 4 percent. I think this particular device is worth trying and experimenting with. The commissions suggestion of equality of listings and unemployed is particularly questionable in view of the fact that our way of collecting unemployment statistics produces, I believe, something like twice the number of unemployed that one gets in countries where people have to go to an employment exchange and register.

Senator PROXMIRE. You talk about the possibility of stabilizing, of having a stabilizing influence in the economy by a wage policy which would encourage a 2-percent increase, a 2-percent increase in wages to match our 2-percent increase in productivity, and therefore have no pressure from the wage sector of the economy at least in an inflationary direction. This would result, as I understand it, as you describe it, in lower prices for industries that have high productivity; is that correct?

In other words, they would not only give a 2-percent wage increase; they would also have a price cut?

Mr. WALLICH. They ought to. That is, they ought to compete each other down.

Senator PROXMIRE. Then in the second place, higher prices would be permitted where you had lower productivity than a 2-percent increase?

Mr. WALLICH. Yes, sir.

Senator PROXMIRE. Recognizing the world in which we live, and recognizing that the structure of price making in the steel industry, the tobacco industry, the insurance industry, the automobile industry, and so forth, is something that we are going to live with for a long time—the prospect really of achieving this kind of thing is pretty remote; is it not? It might be a desirable goal to shoot at, but to expect that we were going to get this kind of statesmanship on the part of either labor or management, is not this expecting a tremendous amount? Is this not more of a dream than a practical policy recommendation?

Mr. WALLICH. It is the way a free and competitive economy would work if it worked well. Ours is not perfect by any means, but I wonder whether we have not just got into bad habits after the war, where price increases are taken for granted and price declines rarely happen. During the 1920's we were not in that situation. In fact, prices in some sectors came down.

As a matter of fact, I think that if I had a more comprehensive index at hand, we would find more data as to declines, for instance, of durable consumer goods. I might refer to electrical equipment, which came down. Steel has been coming down lately. And as I look here at consumers' durables in this Consumer Price Index, I see that in 1959 they reached 113; in 1960 they reached 111.6; and recently they got down as low as 109.9. In other words, price declines are not impossible.

Senator PROXMIRE. Not impossible, but they are very rare, and they do not come close to matching the increases. There is this

ratcheting effect. Is it not true that you go up; you go down a little, but not much, and then you go back?

Mr. WALLICH. Senator, during this period, of course, these industries were paying above average wage increases. Now, granted their productivity may have increased above average, too, but in these industries they were paying 3½, 4, and more, percent wage increases.

Now, if they had been going with 2-percent wage increases, one could really hope that an additional 2 percent per year could come off this index.

Senator PROXMIRE. Do you say they have adopted a policy like this in England?

Mr. WALLICH. In England they put a wage freeze on public employees and employees in the nationalized industries for a limited time. In other words, not just 2 percent per year, but zero.

Senator PROXMIRE. We had that in this country during the war.

Mr. WALLICH. Yes; and it had very undesirable side effects, and we would not want that. The Dutch, I think, have come closest to this kind of policy. They have a kind of national wage bargaining where an employer's organization and a national labor organization intervenes, and the Government is the final arbiter. They have been able actually to produce wage cuts, I believe, of as much as 5 percent in years when they considered this necessary, which I would reject for the United States. They have a special situation. It is a small country. This close intimacy of labor and business has come out of the war. We cannot hope and we should not try to match any of this. But wage policy is beginning to gain ground in Europe.

Senator PROXMIRE. I have just one more question. The reference to your discussion of improved economic indicators. Do I understand—I do not know if you have it in your recommendation or if I saw it in the previous recommendation—is it recommended, at any rate, by the Commission that economic indicators be taken away from this committee and be taken over by the administration?

Mr. WALLICH. It is not quite clear, but they say it should be issued from the Executive Office. As you know, at the present time it is prepared by the Council on the basis of material collected from all of the agencies, particularly BLS and Department of Commerce, and it is issued by this committee. I do not know what would be changed by having it issued by the Executive Office. The same people at the same desks would still supply the same figures, and what good it would do to take it away from this committee, I do not understand.

Senator PROXMIRE. Do you not feel that this committee has and could continue in the future to provide policy determination on the kind of additional statistics that might be useful and what might be curtailed, changed, and modified to adapt it to the economic needs?

Mr. WALLICH. I have not had occasion to think much about this. But I went through the exercise of improving the Indicators last year with the staff of the committee. I think that the fact that we had to do this, and that we were under a certain pressure to come up with ideas and go through with the job was probably productive of better work than otherwise might have been done.

Senator PROXMIRE. Thank you very much.

Chairman PATMAN. Just one brief observation. The question of distribution, I think, is a major one, and which agency would be in a position to distribute these, and would it be too much of a burden on the Council of Economic Advisers. It is quite a major job. I just offer that for your consideration.

Representative REUSS. Mr. Wallich, you talk about cost-push inflation and you end up saying:

> Adoption of a conscious wage policy by governments has recently been recommended by a majority of an OEEC group of experts.

And that you favor something like that here. I am glad to hear you say that. However, why pick on labor? Why not a conscious price policy, too? Is it not a fact that in recent years this cost-push inflation has been a process whereby wage increases and prices chase each other's tail, particularly in strong industries such as steel, and if a conscious wage policy is a good idea, why not also a conscious price policy?

Mr. WALLICH. This is a very difficult matter, because it easily gets into controversy.

Representative REUSS. Are you suggesting that a conscious wage policy does not?

Mr. WALLICH. It certainly does. I seem to remember that the report issued by the staff of this committee, under the guidance of Dr. Eckstein, showed that price increases in steel accounted for 40 percent of total increase in the wholesale price index. Dr. Eckstein also found that in steel there was, as he put it, I think, a probability that deliberate efforts to widen profit margins had been successful and had contributed to price increases.

On the other hand, I think industrywide one can hardly speak of a continued effort to widen profit margins. Industry has had a hard enough time to keep profit margins from shrinking more than they did. For instance, during the first half of the 1950's, corporate profits were 10 percent or better of GNP 4 years out of 5. But during the second half they were less than 10 percent of GNP, again 4 years out of 5.

My impression is that corporate profit margins have shrunk and have, to some extent, buffered the pressure of cost push.

Representative REUSS. My reason for suggesting that a price policy is a necessary component with a wage policy in preventing cost push inflation was precisely because, it seems to me, the record of recent years, including the Eckstein report to which you refer, showed that it is these pace-setting industries like steel which have caused the trouble to spread. I suggest that you yourself have recognized that in your paper when you say that, and I quote:

> In pratice, the success of some unions in obtaining a high settlement becomes the reason for higher rather than a lower settlements elsewhere.

On the other hand, it tends to spread from the pace-setting industries. Therefore, if price behavior in the pace-setting industries like steel is part of the trouble, I should think that a good national policy of groping toward a solution would include some attention to price as well as some attention to wages.

Mr. WALLICH. That I would grant without any futher argument. I see antitrust and specific look-sees into particular situations such

as Senator Kefauver's efforts, as desirable. And more than that, there should be a big push of public opinion originated and propelled by the Government to drive this home. I would like this to be two-pronged and with equal weight on both sides.

So on this, I believe, Congressman Reuss, we have no difference. On the analytical side, I am inclined to think that while there may be some push from administered prices analogous to cost push from labor, quantitatively the great bulk comes from the labor side. Wages are the big factor. Relatively little comes from the business side because corporate profits are small. The evidence seems to show that business has been very unsuccessful in its endeavors to increase profit margins, whereas labor has been quite successful in pushing up its wages.

Representative REUSS. However, I understand that you are saying that while you and I may differ as to the complicity of prices in the whole price-wage upward push, you do agree that prices and wages ought to be equally the object of governmental concern?

Mr. WALLICH. Equally of governmental concern, but not by way of price and wage controls or of hearings. I believe, at a hearing last year, the question of price hearings was discussed. One point that was brought out is that if we subject price increases to hearings nobody is ever going to lower his price, because he knows he may need a hearing in order to get it back up where it was.

Representative REUSS. That is on the assumption that the device used is one whereby you do not get a price increase or a wage increase unless the Government approves, as in the so-called O'Mahoney bill last year.

Mr. WALLICH. Yes.

Representative REUSS. However, there was a so-called Clark-Reuss bill which said that both wage and price increases may be put into effect as now, whether or not the Government agrees with them, but tried to focus the spotlight of public attention on both wage and price increases in the pace-setting industries by the hearing device.

Do you object to that kind of a proposal for informing public opinion as to the incidence of wage and price increases, either prospective or once they have taken place?

Mr. WALLICH. I think that the Clark-Reuss bill was less potentially injurious in that respect. But I think the same tendency for businessmen not to reduce prices, for fear that they would have to appear before a committee, would prevail even if that committee had no mandatory power.

Representative REUSS. I pass to what you had to say on balance of payments, and there I want to applaud your statement that: "We must on no account get ourselves into a position where we would have to keep interest rates high continually in order to attract international funds."

I think that is so important, and I hope it will be widely read. As one of your reasons for this, or rather as one of your remedies for this, you mention in the preceding sentence that we must improve our balance of payments. I would certainly agree with that, and if we do get our payments into balance, then half the battle will be won on freeing ourselves so that we can impose countercyclical low interest rates when that is indicated.

I would ask you this: In addition to improving our basic payments situation, so that it comes closer to being in balance, is it not highly desirable, in order to give ourselves elbow room, to use low interest rates at home when they are needed? Shouldn't the free world evolve improved international monetary arrangements, so that while we or other countries are undergoing payments deficits, as will inevitably occur from time to time for reasons good and bad, we are not in a position where we are immobilized at home from attacking recession by a full panoply of weapons, including low interest rates? Would you agree that we need not only to get our payments into balance but to evolve a better method of cushioning temporary payments in balances?

Mr. WALLICH. I agree that definitely we would be making a mistake in going along with present arrangements without some modifications, say, of the kind that seem to be underway through the IMF. At the same time, that is no solution for the balance-of-payments problem. There is no payments mechanism in the world that can finance indefinitely a large deficit in the balance of payments of a large country.

Representative REUSS. One final question. You expressed fears that the $3 billion additional defense funds requested by the President, would produce inflation, and you wished that a tax increase had accompanied it. I would ask you this question: At the current unemployment rate of close to 7 percent, do you really fear that the addition of $3 billion to the defense budget is going to produce a dangerous inflation, and that the Congress should now in August pass a tax increase to go into effect at once? Do you not think we are safe in waiting to see whether the somewhat blunted impact of that $3 billion of additional spending will in fact push prices to a higher level?

Mr. WALLICH. I recognize that this is a matter of very delicate judgment where very different opinions can be held. I would judge that of the $3.7 billion that I believe the President requested, practically nothing will be spent this year, although the contract placement has some effect. Therefore—I hope I said it, if not, I should correct myself—I would like this tax increase to go into effect January 1. I would assume that something like $2 billion would be spent out of the total in the first half of the calendar year 1962. It is at that time, when this first impact comes, that I would like to see the tax increase come.

I recognize that we are at a high level of unemployment. Nevertheless I think it is quite conceivable that in the course of this cycle we will again get to our traditional level of 4 percent or thereabouts, and that this may happen around the end of next year, give or take half a year.

In these tax and expenditure decisions, one is always dealing with effects that are half a year, a year or even more into the future. It is quite hard to guess what the economic situation and the state of unemployment is going to be at the time the impact comes. I would hope that unemployment by the time these defense expenditures get into motion will be low enough so that a tax increase would no longer look obviously wrong because it was taking place in the face of heavy unemployment.

Representative REUSS. Thank you.

Chairman PATMAN. Mrs Griffiths.

Representative GRIFFTHS. I would like to ask you, Professor Wallich, if you could put into effect at once a reduction in wages at a yearly increase of 2 percent, as reflected in the price level, would this not freeze into effect the high profit of industries at a high profit rate?

Mr. WALLICH. There is that possibility. I would hope that competition, antitrust action, and such pressures as can be brought to bear by public and Government opinion would bring down profit margins that are unjustifiably high, or at least offset the gains these industries would have from lower wage increases.

Now, sometimes high profit margins do have an economic justification. When an industry needs to attract capital, it has to have an above average rate of profit or it will get no more than the average share of investment funds. There I would not argue that we ought to interfere, and I would not recommend administrative interference in any case with high profit margins. But in general I would hope that we can make the economy work as it would if it were a free competitive economy.

Representative GRIFFITHS. What in your judgment would such an effect have upon increasing automation or slowing it up?

Mr. WALLICH. Upon increasing automation?

Representative GRIFFITHS. Or slowing it up.

Mr. WALLICH. I look upon automation as something basically desirable, and I do not know that my recommendation would have an immediate effect. Its broader longrun effect I think would be this: If we could be protected against this upward creep of prices, we could run the economy at a higher rate of capacity than it has been run in the past. We have built this great machine; because running it close to capacity it has generated a balance of payments deficit and has tended to generate inflation, we have had to restrain it by fiscal means and by monetary means. If we were protected against inflation, and I think my proposal would help toward that, we could run the economy closer to capacity.

That would mean then more investment and would mean more automation, but it would also mean more jobs. It would mean in effect a very high rate of employment, because the economy would be working close to full employment.

Representative GRIFFITHS. Would it be possible to alternate half the plant and raise the wages of the other half, thus increasing the price of the product, but also increasing the profit?

Mr. WALLICH. I think this is a thing to take into account. If you have one group of workers where productivity goes up sharply thanks to automation, they might get a large wage increase because the industry pays attention to its own productivity gains and not to nationwide productivity gains. It is the latter that it ought to look to. Those that are left behind, of course, will want a similarly large increase eventually.

So this is a real question, and I think as part of the information campaign that I visualize, we ought to make it very clear that it is nationwide productivity gains and not plant or industry productivity gains that should determine wage increases.

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I might point out that Mr. Reuther, in connection with the improvement factor that went into effect in 1948, and in the proposals he has made from time to time, I think again in 1958, has been very careful to specify that he is thinking of nationwide productivity and not just industry productivity.

Representative GRIFFITHS. Are not the defense industries or so-called defense industries, many of them, the highest profit industries of the country?

Mr. WALLICH. I am not too well informed about this. But take, for instance, a major defense contractor like Boeing or the Douglas Aircraft Co. or General Dynamics. Once in a while I see the quotations of the stock of those companies on the stock exchange, and as far as I can see, they have gone through a rather hard time. They have appreciated recently, but I believe General Dynamics eliminated their dividend recently and I believe Douglas eliminated their dividend for a while.

These companies clearly have not done very well. There may be others that are doing a lot better, and I am not well enough informed to say.

Representative GRIFFITHS. It seems to me that they are the most nearly under the control of the Government to reduce both profits, prices or wages, or all three, of any group, and I must say I think the Government has shown its incapacity to reduce wages or prices in those particular industries.

In your statement you point out:

> It would be futile to set a target not knowing what it would take to attain it. Our best plan is to act vigorously now for more rapid growth, and to observe the results.

What action?

Mr. WALLICH. I would aim at a strong budget, a surplus, if possible, at high employment. I think also of a high level of taxes and expenditures. There are many kinds of public expenditures that can help growth, although one must be discriminating. If a strong budget position allows us to reduce interest rates, I would like to see interest rates reduced so that investment can go forward better. I would like to see a change in the tax structure, principally with respect either to accelerated depreciation or some reform of the kind that the Treasury has proposed, the investment tax credit. I think a broader tax reform is desirable.

For instance, I think if it were feasible without too much political complication, which I am not competent to judge, to reduce the corporate tax, that would probably do more than anything else to feed investment funds into industry where they would do the most good.

Representative GRIFFITHS. Approximately how much?

Mr. WALLICH. Well, I believe every point of the corporate income tax amounts to 2 percent of the total take, or a little over $400 million. I do not think we could afford a very large cut, so it would have to be within the limits of a very few points.

Now, if this does not sound altogether antisocial, I would say that we should begin to look toward a sales or excise tax coupled with a luxury tax. I would appeal here to Professor Galbraith and Professor Hansen, who certainly are not suspected of being reactionaries. They are coming out for a sales tax.

A nation reaches its limits of what can usefully be done with the income tax without interfering with the economy, though I do not believe in any rigid or immutable limit. The United States has the highest income tax in relation to the rest of its tax revenues among major nations.

All other nations that I know of have higher ratios of indirect taxes to direct taxes than the United States, and most, if not all, of these nations are growing faster than we.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Thank you for your testimony.

You may extend your remarks in connection with your answer if you desire, sir.

Mr. WALLICH. Thank you, Mr. Chairman.

Chairman PATMAN. Professor Samuelson, we have had you many times before this committee. We always profit from the testimony that you give us. You may proceed in your own way, sir.

STATEMENT OF PAUL A. SAMUELSON, PROFESSOR, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Chairman, it is a pleasure to testify here, and an extra pleasure to be testifying in the company of my old companion in arms, Henry Wallich.

We are practically a vaudeville team by now, like Weber and Fields. I am not sure which is Weber and which is Fields, but we always sit on these occasions in the middle of the table, I am a little to the left and he a little to the right.

I am looking forward to the day when we change positions, like the piano virtuoso who crosses hands on some of the more difficult parts. If he will cooperate with me I will cooperate with him.

It is an extra pleasure because there always has been one thing which has been lacking in my life; namely, I regret that I never have had a Yale education. And I feel in his small way on these occasions Professor Wallich helps remedy that gap in my background, for which I am grateful.

In testifying before this committee about the Commission on Money and Credit report, I should like to make clear that my views are wholly personal. I have no official governmental or private connections.

To emphasize this point, I was rash enough to say one time before a Senate committee that I represented only my own views and those of Mrs. Samuelson. But I regret to report that, after going back to headquarters, I was told in good Henry Wadsworth Longfellow fashion, "Speak for yourself, Paul."

So I represent only my own opinions here.

I ought to disclose, as the SEC requires me to, that I served on the Research Advisory Board of the Commission on Money and Credit, but that I feel no personal responsibility for its conclusions. As Mark Twain said:

> Many a man will die to defend his own home; but few of us will go to the stake for the sake of a boarding house.

Fortunately, this leaves me as free to compliment the Commission as to criticize.

The findings of the Commission on Money and Credit are, I believe, very important and are on the whole in the right direction. It is absurd to belittle its contribution by irrelevant comparisons with the Aldrich Monetary Commission of a half century ago. What the great French mathematician Lagrange said about Sir Isaac Newton is to the point here:

How undoubtedly great was Newton. But also how lucky. For he found the system of the world; and of course there is but one system of the world to be found.

Fifty years ago America wanted, and desperately needed, a central bank. The Aldrich Commission gave us our Federal Reserve System. It would not be possible for any group, however gifted, to perform a comparable function today.

Abroad there have been a number of studies and commissions in which objective groups have reexamined in recent years the monetary systems of the United Kingdom—the Radcliffe report—and in Japan a similar commission.

The Radcliffe report, on the whole came out for an increased coordination of the activities of the Bank of England with those of the Government, thereby incurring the criticism of the dying-out group of experts who hanker for a completely independent central bank. In Japan, the majority report of a similar investigating group declared in favor of ultimate responsibility for the actions of the Bank of Japan as being in the hands of the Government. Evolution in other countries, and the recent battle between former Governor Coyne of the Bank of Canada and the cabinet there, point up the same fact: There cannot be in a modern democracy an insulated pocket of power that, however rightmindedly—or leftmindedly—acts contrary to the wishes of the authorities.

The Commission on Money and Credit has gingerly, within and between its lines, recognized this important fact of life; and has, for this very reason, been the target of old-fashioned criticism. There has even grown up the fiction that this distinguished group of citizens, consisting of, by my count, 10 pillars of the financial community and 10 further representatives of labor, agriculture, industry, and the universities—without much representation, I might say, from the universities—have been brainwashed into accepting dubious doctrines. On the contrary, anyone who has observed the process of group debate will testify to the intellectual independence—I will not say stubbornness—of the Commission members. If every 2 years we were to set up a similar group of public leaders, they would after independent examination come up with pretty much the same recognition of the needs of the times, perhaps with even the same footnotes of vigorous dissent. And, I am sure, they would meet with the same criticisms I have been describing.

There are few vestiges left of that charming pre-1914 world. (That, Henry cannot possible remember, and it is even dim in my mind.) the Viennese waltz is gone in favor of the cha-cha; stately Edwardian coaches have been replaced by compact hot-rods; peaceful international relations are but a memory or a dream. But the fraternity of central bankers bravely carries on under heavy odds. The Kings of Europe used to address each other in their letters as "Dear Brother." One almost suspects that the central bank governors addressed each

other as "Dear Cousin." (Henry can, perhaps, tell me whether that is correct or not.) Well, whether or not the Commission on Money and Credit has brought joy to Mudville, one cannot expect it to have elicited champagne toasts in the central banks around the world. I may say, in my travels I found that to be true of the Radcliffe report. For, as Sir Theodore Gregory, an economist of the old school, and a distinguished British economist, said quite seriously in a public lecture in London a few years ago:

The motto for central banks should be "Who touches one, touches all."

No serious economist doubts that 25 years from now the Federal Reserve will be found to be working in complete harmony with the Treasury—I mean in the sense that any two units in a pluralistic government like ours are in complete harmony. It will not matter, I believe, whether the execution of debt management takes place in the marble palace of the one or the stone building of the other, so long as it takes place in a coordinated way and in the interest of economic stability and progress.

I want to emphasize that this does not mean that the Secretary of Treasury, with that failing common to old-fashioned Secretaries of Treasury—namely desiring the vanity of low interest rates debt issue at all times and all seasons—will be dominating this group effort. But rather that the Secretary of Treasury in this enlightened age, like the central banker in this enlightened age, will have the same goals of economic stability and progress firmly in their minds.

The Commission on Money and Credit points a small finger in this general direction, and the nature of the American system of checks and balances is such that the change in our structure will be slow and gradual.

Indeed, the day may first come, Mr. Chairman, when the Federal Reserve, the creature of a populistic Congress, will flee from the "demagogues" and hanker for asylum and a measure of freedom within the folds of the Executive.

Now, in connection with the report, it is my opinion that it is not so important whether the Board of Governors consists of 5 or 7 persons or whether the regional banks have representation on the Open Market Committee. What is important is that each newly elected administration have the power to name the Chairman and, most important, that monetary decisions be made on the basis of the same considerations that should guide fiscal policy decisions, namely in terms of policies that strike that difficult right balance between too much and too little total dollar demand, too much and too little capital formation, too much and too little balance of exports in terms of imports.

No expert on the mechanics of inflation believes that monetary policy has some special competence to stabilize the price index, while fiscal policy has some special competence to maintain full employment. Either instrument can by itself add to or lower the total level of dollar spending, and the final parceling out of such resulting changes in total spending as between output and price changes is no different from an increase in total spending brought about by montetary policy than one brought about by fiscal policy.

This fact is not always recognized. But if this technical fact of economics comes to be agreed upon, then the present situation in which we generally find the central bank tending to favor the goal of

price stability more strongly relative to high employment and growth than does the Executive or Congress, will be seen to be an anomalous one. Indeed, it is hard to know what are the best compromises to make when such goals seem to be in conflict—and, I may add, they are in greater conflict than the final version of the Commission report makes clear.

But there is no reason why such an argument should be decided differently in the monetary than fiscal sphere.

I wonder how the partisan advocates of "independence of the central bank" would feel in the not unthinkable case where the Board of Governors were "packed," and I think I ought to put quotes around the word "packed," with ardent growthmongers—I am not sure whether that should be growthmongers or growthmongerers, the legacy of a transient populist Congress—men keen to push for the last full measure of full employment with small consideration for the goal of price stability?

I do not think there is room in this country for a House of Lords, and even the Supreme Court, as Mr. Dooley said, does follow the election returns.

Since I shall be available for questioning, I need not here evaluate each and every recommendation of the Commission, telling why I like the proposal to abolish the 25 percent gold cover and think poorly of the innocuous discussion concerning debt management. Let me merely summarize a few reactions on fundamental matters:

1. The Commission was right to come out against the "bills only" doctrine. Recent departures from that policy, which I may say I applaud, while not momentous in their import, seem to me to confirm the wisdom of having the Board free to deal in Government securities of all durations.

The Fed's previous stand on this matter was a cranky, idiosyncratic one, not called for by central banking tradition, by experience abroad, or by orthodox and modern monetary analysis.

I may also remind you that the New York Federal Reserve Bank and certain other parts of the Federal Reserve System were in the beginning strongly against such a change.

2. The need for closer coordination of the Federal Reserve and the executive branch I have already touched upon, including the desirability of having this Chairman serve at the will of the President.

I notice that this goes beyond the actual recommendation of the Commission. The Commission merely asks that the day of his inaugural the Executive have the privilege of naming the Chairman.

I may also say, Mr. Chairman, that the tradition, the unwritten tradition, in this country is a very unclear unwritten tradition, and like many unwritten traditions it cannot be leaned upon. I do not think that even Mr. Cannon, excellent parliamentarian that he is, can tell us exactly what the unwritten tradition is in this matter.

I myself happen to think that the issue of the regional versus Washington authority within the Federal Reserve System is a minor problem. In point of historical fact, the officers of the regional banks, in my opinion, have more and more become the willing cooperators with the Washington office. I think, perhaps, you ought to put quotes around "cooperators" there, too.

Turning to fiscal matters, I applaud the recommendation of the Commission that Congress allocate under proper safeguard to the President the right to lower or raise tax rates quickly and within a limited range, the purpose of increasing the stabilizing potency of fiscal policy.

Such a reform, most economists think, would contribute greatly to the admirable "built-in automatic stabilizers" that already serve our system so well.

Now, I realize that Congress is very properly reluctant to give up its authority in revenue matters without good reason and without insuring careful limitations.

But I insist the proposals like these are not quixotic. They are bound to come, and they will come in our lifetime, and the sooner the better. Considerable experimentation will be needed, and I honestly do not think that the Commission has gone as far in its recommendation as America ought to go in this matter. But I suspect they have gone farther than Congressmen will care to follow, and one can only hope for a period of discussion, debate, and education in this important area.

Ten years from now the Commission on Money and Credit may be forgotten by the public. But scholars will remember it fondly if its recommendation helps give rise to evolutionary developments in this important area.

In public affairs, not to be quixotic is to be pollyannish, and, although the Commission has jousted with few windmills, when the rollcall is made, when the roll is called, they will be found to have been, I think, on the side of the angels.

Chairman PATMAN. Thank you, Professor.

I want to comment on some of the things you have said, and ask a question, if you please.

You said America wanted and desperately needed a central bank. The Aldrich Commission gave us our Federal Reserve System. You did not say it gave us a central bank.

Now, the way I construe the Federal Reserve, and I do not claim to be any expert, but President Wilson was against a central bank, and the 12 banks, original banks, were created. According to the way I view the Federal Reserve Act, we did not have a central bank until 1933 when the Board of Governors constituted an Open Market Committee for the first time, and since all those Governors were selected by representatives of the private banks, that made our country very vulnerable. In 1935 the Open Market Committee was changed, of course, to the present 12 members, divided 7 and 5.

Now, up until that time I did not consider that we had a central bank, did you?

Mr. SAMUELSON. Well, I am afraid I was guilty of poetic license there, and I was using language reminiscent of the popular song, "I May Not Be the Best Gal in Town, But I Will Be the Best Until the Best Comes Along."

That was an ersatz central bank, understandable in terms of the American suspicion in 1912 of centralization and, as I have described it elsewhere, it was a case of our wanting to go swimming but not wanting to get wet, not wanting to go in the water. But we have evolved, and we are still evolving in this respect.

Chairman PATMAN. I agree with you that 25 years from now, and before that time, the Federal Reserve will have to work in complete harmony with the Treasury. There are a lot of things to be said about that.

I have never known but one time when a member of the Federal Reserve Board or the Federal Reserve Board failed to carry out even a veiled suggestion or a subtle suggestion of the Chief Executive, and I venture to say now if the President of the United States were to suggest that any member of the Federal Reserve Board withdraw or resign, he would do it.

I venture to suggest that if the President of the United States were to indicate to Mr. Martin that he would like for him to resign as Chairman, I think he would do it, or even a member of the Board.

There was only one exception to that, and that was back during the time when Mr. Truman was President. He was not a very popular person at certain times, and his popularity line was down rather low, and the Open Market Committee had been seeking an opportunity for a number of years to declare their independence, and when his popularity line was down at what they considered to be a low point, and when they could get by with it, they did declare their independence, equal to secession from the Government, I think, and almost constituted, according to their way of thinking, as I construe it, a fourth branch of Government which, I think was clearly wrong, and I think they have gone too far.

I think it is terrible that we have these people who represent private interests on the Committee to determine the supply of money and interest rates.

Do you know, President Wilson said that he would never agree for a banker to serve on a board or committee where decisions were reached as to the supply of money or interest rates; that he would just as soon see presidents of railroads on the Interstate Commerce Commission to fix passenger and freight rates, he was not about to do that, and I think Mr. Wilson was right.

I have noticed this Open Market Committee, and I have noticed the way they have functioned. I think they have been going farther and farther afield all the time, and in doing that I think they are violating the law in the meetings of the Open Market Committee.

Have you considered that having all 12 of the presidents there who are selected by the representatives of private bankers, and 7 members of the Federal Reserve Board? They are at every meeting of the Open Market Committee.

That has been brought out for the last 2 or 3 years now that they admit it openly, and I think it is in clear violation of the law.

They take part in all of the proceedings 12 to 7 concerning the supply of money and the rate of interest and, I think, it is wrong, and I think that it is rather evident, without attacking the members of the Board, without questioning their integrity, and I think that our monetary policies have been banker influenced, and are being banker influenced today. I certainly appreciate the statement which you have made about the Federal Reserve Board going too far afield, and that the Chairman should be selected by the President.

I invite your attention to rather clever language that was used in this recommendation of the committee on money and credit. It sounds very liberal and good and generous to say that the President can select a Chairman. But notice the Chairman must be selected from the then existing Board. That is what this committee recommends. It does not recommend that he can pick out one of his choice somewhere and put him in there.

He is restricted in his choice to the ones who are members of the Board.

So when Mr. Kennedy came in, if this report had been effective, Mr. Kennedy could not have selected a person of his choice, he would have had to select one who was already on the Board, so I do not think that is going far enough. I think it should be done in a way so that the President will have his choice on that Board as Chairman.

I notice in your statement here there is no room in this country for a House of Lords, and even the Supreme Court, as Mr. Dooley said, does follow the elections returns. Well, the Federal Reserve has almost constituted itself as a fourth branch of Government, and I do not believe that they are as sensitive to the election returns as even the Supreme Court. In fact, they brag about being isolated from the Congress and from public opinion, which I do not think is good in any democratic form of government.

So I just want to express my appreciation to you for your statement. Do you want to comment?

Mr. SAMUELSON. May I comment? I have no knowledge of the personal relationships between the past Presidents and the Federal Reserve Board. But I should say something about the historic function of central banks.

Even in the so-called good old days when Montague Norman was at the peak of his eminence, he admitted that in the last resort when there was a difference of opinion between the Bank of England and the Government it was the Bank of England that had to yield.

But, he said, the head of the central bank has the right, and indeed the duty, to nag the Government; and his grandest moment may be the moment when he hands in his resignation. Now, that is a right actually which every public officeholder has, that you can go in a blaze of glory, giving your opinion.

The difference is that in England and in almost any of the countries that we would be speaking of, including the late Canadian incident, there is a cabinet system of government, and the Government is a term that does involve both Parliament and the executive; whereas under our division of powers we have an Executive more distinct from the Congress.

Now, to the best of my knowledge, no public spokesman of the Federal Reserve Board has ever said in public or privately that the Federal Reserve had a right to do whatever it wanted without regard to the will of the Congress.

But at certain points, I believe, in recent years there was a strengthening of an older doctrine which had been somewhat abandoned, I believe, that the Federal Reserve, when the chips were down, did have a last-resort right for independence as against the Executive, and that does complicate the comparisons.

Chairman PATMAN. Well, I can cite you an instance, Professor. Mr. Hayes, president of the Federal Reserve Bank of New York, the only president who is always on the Open Market Committee, testified, in answer to questions before this committee, that the Open Market Committee was set up as an official committee, and members of that Committee are not under obligations to anybody except to their own conscience, that they are not subject to Congress or to the people. He did not say it in that language, but the language he used would indicate that that is the inescapable conclusion, that he is not responsible to anybody as a member of the Open Market Committee; that they act according to their own consciences, each one. That is in the testimony.

Now, that is going pretty far, but that is the attitude they have all the way through, that as a Federal Reserve Board member—maybe they have an obligation to the Congress and to the President, the Executive under our form of government, we will say. But when they move into that room with the Open Market Committee and pull down that hat as a member of the Open Market Committee, they are obligated to nobody except to their own consciences.

They are going rather far on that and, if that is not a fourth branch of government, I would like to know what you would call it. I am glad you brought up the point you did here in questioning that sort of attitude and disposition.

Would you like to comment further?

Mr. SAMUELSON. Well, I am not familiar with that.

Chairman PATMAN. I put that in the record at this point.

Mr. SAMUELSON. I would say that it is possible that the statement quoted had reference to something which is true of every Government official; namely, that he must answer to his own conscience. But that means in a system of law and order that one resigns. One always has the freedom when one's conscience does not permit one to do what is required to resign, and perhaps no more than that was meant in this context.

Chairman PATMAN. Well, I am not attacking Mr. Hayes. He is a mighty fine man, but his testimony was rather forthright in that direction and along that line. I shall put it in the record at this point.

(The statement referred to follows:)

STATEMENT OF ALFRED HAYES, PRESIDENT OF THE FEDERAL RESERVE BANK OF NEW YORK, BEFORE THE JOINT ECONOMIC COMMITTEE, ON DECEMBER 10, 1956, CONCERNING THE OPEN MARKET COMMITTEE

"The 12 members of the Open Market Committee, which was established by statute, sit and reach decisions as responsible individuals, not as representatives of any constituency. Each must find the answer, in the light of all the facts and his own conscience, to the question: 'What policy of credit control would be the best policy under present conditions for the economy of the United States?' "[1]

[1] Hearings before the Subcommittee on Economic Stabilization of the Joint Economic Committee, 84th Cong., 1st sess., on "Monetary Policy: 1955–56," p. 143.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Samuelson, you say:

What is important is that each new selected administration have the power to name the Chairman.

I take it that this is the smaller finger to which you refer, the slight, gradual adjustment in the direction which you think is wise of Federal Reserve Board coordination, cooperation with the Executive; is that correct?

Mr. SAMUELSON. Well, that is one of the things. There are some other minor recommendations with respect to coordination.

Senator PROXMIRE. Well, if they abandon the "bills only" doctrine, I take it behind that was the notion that if they buy, deal in, long-terms more than they have in the past, they can have a more fundamental effect on the economy, in a sense, than if they deal only in bills. If they deal only in bills, as I take it, this is a matter of technical adjustment to a great extent.

Mr. SAMUELSON. Yes, except if the American people decide that we do want a buffered central bank, free from immediate political influences, one would still strongly urge that in order to do their job of economic stabilization they should not tie one hand behind their back by a self-denying resolution to deal in bills only.

Senator PROXMIRE. Yes. I am trying to get at these two concepts of economic stabilization.

Mr. SAMUELSON. Yes.

Senator PROXMIRE. Whether or not that is their duty, many people argue that should not be their duty. Their job, at least it should not be their principal duty—their principal duty is the job of maintaining order in the money market. It is a technical job, and so forth, and very often when they come before this committee or come before the Banking Committee of which I am a member, they give technical objections as the reasons why they are not stabilizing the economy in coordination and cooperation with the Congress and the President and, therefore, these two things are related.

If you extend their open market policy to include long-term obligations, then one of the reasons would be so they could operate in that area.

Now, you say:

> Either instrument—

meaning fiscal or monetary policy can by itself, and you added to your script here, you do not have it here—

> add to lower the total dollar level of spending, and the final parceling out of such changes in total spending between output and price changes—

and here again you interlined an interjection, you said—

> is no different—

as I recall in your presentation, you said is no different.

If this is true, the position I have taken, and I admit I do not feel it very firmly, because I am certainly not anything as expert as you are in this area, the position I have taken is that it is much more possible in a system of political freedom to defend aggressive fiscal policy in this area than it is monetary policy for a number of reasons.

For example, I think fiscal policy tends to interfere a little more directly at least, with the individuals. When you increase taxes you are depriving him of part of his income, part of his right to spend that income where he wants to spend it; whereas, if you follow a policy of increasing interest rates, perhaps you have somewhat the same in-

direct effect, but it is accepted by society, and I think that it is harder to make a case that the interference of the Federal Government is as great.

Do you see any reasonable distinction at all here? Don't you feel there might be a little more danger of interference in the freedom of the individual if you follow a very aggressive policy of fiscal stabilization or fiscal stimulation of growth than if you tried to rely more on monetary policy?

Mr. SAMUELSON. The quoted sentence, which I did not revise, referred purely to a technical point having to do with the effect on P, the price index, as against Q, the production index.

Senator PROXMIRE. Very good.

Mr. SAMUELSON. In, let us say, a simplified relationship of the product equal to PQ. I do not wish to argue for the moment that there are not other repercussions such as distributional repercussions. There are repercussions on the composition of the full employment income as between capital formation and as to consumption, and if time permits I would like to say a word in connection with Henry Wallich's remarks about growth. He said some very kind things——

Senator PROXMIRE. Go right ahead.

Mr. SAMUELSON. He said some very kind things about me, and I have been called a great number of things, but I have never been called the architect of the Eisenhower fiscal policy, and I felt that what he gave so lavishly with one hand, in one short blow he took away.

Senator PROXMIRE. I saw Senator Douglas indicated that he disagreed a little bit with Professor Wallich on that point.

Mr. SAMUELSON. Yes. It is true that in the sacred files of this committee there will be found by me some years ago the "New Look in Taxes," and it does enunciate the doctrine that one of the ways that a mixed enterprise system like our own can influence its rate of growth is the following: Out of a high employment level of income, by means of an austere fiscal policy, coupled with an aggressively expansionary monetary policy, the proportion of the full employment output that goes to consumption can be reduced, and the proportion going to capital formation can be increased.

But I do not recognize in that prescription which I wrote out so neatly anything that was done in the last years under discussion.

I felt a little bit like the case where somebody once wrote a book called "Economics in One Lesson," and a friend of mine laughed. I said "Why?" and he said his mother was out driving and she had committed a misdemeanor that women are accused of—because there was a big truckdriver, who leaned out of the window of his cab and said, "Go back for that second lesson."

I think only half of the prescription that was involved here was taken, namely, the austere fiscal policy. I do not recognize in the activities of the Federal Reserve in the period under discussion that expansionary monetary policy which was part and parcel of the full package.

Now, I agree it is very hard to read the historical. Some of us who were nearer to it than others see it from a certain perspective, but my interpretation of events in the last part of the 1960's would differ substantially from Mr. Wallich. Perhaps that can come out in other discussions.

But to return now to your question, money won't manage itself. That is something that orthodox monetary economists have agreed upon. I do not think that it has been seriously argued in the great central bank literature that the duty of a central bank is not to help stabilize. Now, it is perfectly true that you stabilize within the constraints of the technical conditions of the market, and it is perfectly justified and a justifiable thing to say that we had to deviate on this occasion in this regard from what would have been more stabilizing because of the pinch in the money market and the technical conditions.

Senator PROXMIRE. If I can interrupt at this point——

Mr. SAMUELSON. Yes.

Senator PROXMIRE (continuing). Isn't it true that we are talking about stabilization, and it is my fault, I got on to that point and argued it——

Mr. SAMUELSON. Yes.

Senator PROXMIRE. Yesterday Gaylord Freeman, a member of the committee, and a distinguished banker in Chicago, argued that the Federal Reserve is the stalwart defender of stability, of price stabilization, and that you have all these pressures in the economy, political, and economic pressures, to get more, all of which are inflationary, although they all deny it.

It is labor, business, farmers, politicians, all of them tending to act in a way which pushes up prices, and the Federal Reserve tends to, feels they have to, stand athwart that.

Now, it is this kind of emphasis on stability, it seems to me, which overlooks the responsibility for growth at a time when we have this technological burst in society, and when growth is so enormously important, when we see competing and complementary economies growing at a very rapid rate; and if stability is the purpose, they can achieve it all right, but if they do at the fantastic cost in retarding growth——

Mr. SAMUELSON. I quite agree, and I agree with the diagnosis of Mr. Freeman, that we are in a pluralistic society; we are in a society where legislation decisions are made on an adversary basis. It is very understandable that a high representative of the Federal Reserve should occasionally say things in public which, as a distinguished scholar, let us say, he would not subscribe to; but say them on the ground that, first, statements by him, like admissions against interest in a court of law, are given a certain weight, plus the second fact that in the adversary procedure of the counterclaims of growth and high employment there is almost nobody present at the banquet to speak for price stability and, therefore, he must lean over backward or lean over forward in overemphasizing the desirability of price stability, not because he believes that it should be overemphasized to that degree, but in the opinion that when he leans over backward and other people are leaning over in the opposite direction as a resultant of this better decisions will come.

Now, that is a fact of life. In the enlightened age that I have dated only 25 years from now this will cease to be the case. The central bank will no longer have that feeling which she must have in the modern world of a persecuted minority group which makes for the cohesiveness that I described. He now feels like little Peter at the dike, the only man drawing wages with a watching brief for the price level.

I think that the need for that in this enlightened age will have disappeared, and you will find a random distribution around the committees of the Government, and it may turn out that the expansionist will be the central banker on some particular occasion, and the contractionist will be somebody in the fiscal policy sphere.

We have lived in a schizophrenic world though, where monetary policy has bloomed as a weapon of restriction, and fiscal policy has bloomed as a weapon of expansion.

Now, to be sure, there are certain technical asymmetries in the field of monetary policy suggesting that at a time of deep depression monetary policy at that time is not so potent to create expansion. It is also true, by the way—and this is overlooked in almost every discussion—that monetary policy at such time also is less potent for contraction in that deep depression period. It is perfectly symmetrical relationship working in either direction, but with low leverage, whereas in times of very tight money the monetary policy is both potent for expansion and contraction.

It is a truth, and Per Jacobsson reminded us of it recently, that it is much easier to drive the mechanism of central banking in a high-interest environment than in a very low-interest environment for technical facts having to do with liquidity traps and so forth; particularly at high-interest times the man at the wheel has that wonderful feeling of response, the system is not mushy at all. Each time he makes a move he can feel his own effect there in contrast to a steering wheel with very loose play.

Of course, the Good Lord did not create the earth in order to make life easy for the central banker, or to give him the fine feeling, as the psychologist says, that the situation is under control. But this slight technical asymmetry, which was of much greater relevance in those bad old days when serious depressions had considerable probability of having to be reckoned with, that should not blind us to the fortuitous characteristic of the asymmetry that exists in the political sphere where it is always the central banker dragging his heels with respect to employment, and always the executive branch—excuse me, Henry, I do not want to libel you—it is pushing in the direction of high employment and high-pressure economy.

Senator PROXMIRE. That brings me to my last question. There are lots of reasons why I am concerned on relying on fiscal policy for expansion, particularly in view of the difficulty of really achieving it on the basis of our past experience by deficits, and so forth.

But in the third point that you underline and emphasize and applaud, as you conclude, you say:

> I applaud the recommendation of the Commission that Congress allocate under proper safeguard to the President the right to lower or raise tax rates quickly, and within a limited range, for the purpose of increasing the stabilizing potency of fiscal policy.

Well, once again I ask you, this is probably the boldest and most specific recommendation made, at least I think made, by the Commission on Money and Credit, and it is really not a monetary recommendation, it is a fiscal recommendation. This is the one they make, and I think it relates to almost everything you have just said, that they, from the monetary standpoint, are likely to operate with, as Per Jacobsson, as you quoted him saying, at a high-interest situation

and restraining inflation and let the fiscal procedure take care of expansion.

But I can see all kinds of difficulties and troubles, and I just do not think Congress is likely to be in that very kind of a mood. We just sweated out, although I favored very strongly, a far greater delegation of authority to the President and the Secretary of Agriculture with regard to farm programs earlier this year. We did not come close to getting that enacted.

Mr. SAMUELSON. In foreign aid there is a similar issue, in the foreign aid bill, a similar issue is involved.

Senator PROXMIRE. That is correct. Here again we are having great difficulty, although President Eisenhower, Vice President Nixon, Mr. Dulles, and Mr. Herter all were for it.

Mr. SAMUELSON. May I say that when the reciprocal trade program at the time was first discussed, it was considered to be unthinkable that Congress would relegate the authority to the Executive, discretionary authority, which was given to him and which, in fact, was the necessary ingredient to make the reciprocal trade program get off the ground.

Senator PROXMIRE. Unfortunately, Congress may take it back again next year, too.

Mr. SAMUELSON. Yes.

Senator PROXMIRE. At any rate, I am just asking you whether you would not agree that it would be awfully difficult for a President to increase taxes.

Mr. SAMUELSON. No, I do not think so.

Senator PROXMIRE. It would not be hard for him to cut it, but to increase—can you give me a month and day since 1954 when he would have increased taxes?

Mr. SAMUELSON. I will give you an example and simply quote an eminent authority writing in the London Financial Times, namely myself, that, in my opinion, just my guess, it took more courage for the President not to ask for a tax rate increase probably on this last Berlin go around than to desist asking for it.

I think I read in the press of many political people arguing that the President could hope for a favorable reaction from the country, that the country was desirous of showing its willingness to sacrifice; but he did not ask for the tax rise for economic reasons. I think that there are many cases in history, even in the postwar years, where people have said that it would be unpolitic for the President to raise taxes, ask for tax rate increases when, in fact, he has done it, and where it has succeeded. I would even criticize Mr. Truman on one occasion, namely, in the 1948 recession, some months after the recession was underway and was recognized to be underway, he was still asking for a tax increase. Also the surplus which occurred in the last part of the 1940's was by no means an automatic surplus, created with unchanged tax rates.

Senator PROXMIRE. If we had President Samuelson, can you give me a date from January 1, 1954 to date when you would have recommended a tax increase?

Mr. SAMUELSON. Well, it is possible that that day could come any time, although if time permits I should like to comment on Professor Wallich's testimony on this particular point, lest it be thought that

having sat in the same room with him in silence any acquiescence and agreement was implied by my silence.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman PATMAN. Use the microphone.

I have a statement here on the recommendations contained in the report on the Commission on Money and Credit prepared by the staff. It defines the issues involved, and without objection I will place it in the record at any place the staff feels it should go, either in the beginning or the end.

(The document referred to appears in the appendix. See p. 465.)

Chairman PATMAN. Mr. Reuss.

Representative REUSS. I would suggest that not asking for a tax increase is a form of heroism I am willing to indulge in any time.

I have enjoyed very much Mr. Wallich's and your delightful and lighthearted discussion of what is often known as the dismal science. I do not know whether your Weber and Fields analogy to you and your running mate, Mr. Wallich, is accurate. Maybe it would be better to talk in terms of Milton and say that Wallich contributes "the nods and becks and wreathed smiles," and you provide "the quips and cranks and wanton wiles" in this afternoon's discussion.

I have one question. You expressed dissatisfaction with the CMC's discussion of debt management. I would be interested in having you spell out why this left you cold, if it did.

Mr. SAMUELSON. Well, in the first place, the easiest thing in the world to teach a parrot or at least for a parrot to learn is to say, "Lengthen out the debt."

There is the feeling that the debt is overhanging, and if you could somehow have it overhanging with a center of gravity of 7 years ahead, that the burden is not so pressing upon you.

Actually, the debt is just like the banking system. Bankers, if they like, could develop ulcers every night. They have demanded obligations. If everyone wanted to he could come in and ask for his money immediately, of course no banking system based on fractional reserves in the world could ever stand up to it.

Similarly, if you want to scare little children, you can just imagine occasions when nobody in the marketplace will buy any of the bills of the Government. There is involved a mistaken failure to recognize that we have a going system; and that coming back to the market, taking all the time of the Under Secretary of the Treasury, and so forth, and requiring phone calls in the marketplace is not a burden any more than breathing and eating is a burden. We do not despair because we have to take a breath every hour of our lives, and neither need we lengthen the debt simply to forestall its turnover.

I believe, and this is contrary to the opinion of many members of the Joint Eonomic Committee, and also of some of the staff reports of the Joint Economic Committee, I do believe that there is some economic advantage to be gained from a cyclically stabilizing debt management policy.

I find it very strange that the "bills only" adherents of the Federal Reserve System are lying in the same bed with the majority of the Joint Economic Committee—because all of the arguments that are used for "bills only" are used and can be used and have been used in exactly the same logical fashion with respect to the doctrine that you should not have an anticyclical debt management, but instead should

in time of depression when rates are low force out—perhaps I should not say force out—put out much long-term debt. In terms of the straight economics of the situation, I believe that when demand is overexhuberant one extra string to your bow would be to increase the composition of far money as compared to near money, long-term debt being the far money, and so you can get some contribution toward stabilization from this weapon.

The Commission's report, I think is not very creative on this. With respect to such a problem as the purchasing power of bonds, there is no thought-out exposition that I can see that carries weight with me and with many scholars as to why that should not be done.

It is in no sense a pioneering treatment, and I thought it a little superficial, frankly.

Representative REUSS. You think then that debt management should be an important counter-cyclical device, and you disagree with the CMC in their saying that it should be only a secondary or quite unimportant counter-cyclical——

Mr. SAMUELSON. Or that rather one should forget the cycle and lengthen the debt for its own sake.

Representative REUSS. I beg pardon?

Mr. SAMUELSON. The Commission, as I understand the Commission report, holds that at least initially one should forget the cycle and even make the cycle worse, if that were necessary, in the interest of lengthening out the debt.

Representative REUSS. Well, you do them an injustice there. They did not say that.

Mr. SAMUELSON. For which I apologize.

Representative REUSS. Well, you should. You should be really angry at me rather than the Commission, because this was a position I was urging yesterday on Mr. Freeman who represented the Commission. I think the Commission took—we can both check this later on—I think they actually took a different view.

However, let me pick up a point you raised.

Mr. SAMUELSON. May I simply say that I find it hard to be angry with a man who quotes Milton so eloquently. [Laughter.]

Representative REUSS. Let me take you up on this point. Are you saying that lengthening the debt is a pure phony and that it should be cast aside as an instrument of policy entirely?

Mr. SAMUELSON. No. I simply say that repeating in season and out of season that the debt should be lengthened is a bad precept for policy. My own view is the following: One, alterations in the lengthiness, if I can coin a word, of the debt has some potency for cyclical stabilization and, in my opinion, ought to be used as a supplementary measure.

Secondly, the Treasury should not have as its goal purely the minimizing of the interest cost of the debt.

Rather, it should have its goal the following: Given the same degree of success with respect to stabilization, choosing among packages which can create that, it should pick the one which does minimize the interest cost to the Treasury. I do not think that the Commission's report is very perceptive on this distinction, although one of the monographs written for it, which I hope will be published, is very clear on the problem.

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Now, from the standpoint of minimizing the cost to the Treasury, I believe that every merchant should have a full line. If there are customers who want to have cheap margarine, understanding what they they are getting, they should get it.

If there are customers who want to have butter flown in from the country this morning, they should get it, if that will add to the total satisfaction.

The same is true with respect to the marketing of the debt. There is a desire and a need and an effective demand among our various financial institutions for a whole spectrum of debt.

Some such commercial banks for secondary reserves need bills; others, such as insurance companies who have payments that are due in the future, want longer terms. It is evident that the Treasury will serve a social function and also save money to itself if it meets these needs.

That does not mean laissez faire debt management or that the debt will manage itself simply by catering to the effective demand in the marketplace.

But it does mean that within a successful program of stabilization you ought to take account of this; and actually that is a very powerful argument for purchasing power, preservation-of-purchasing-power bonds.

Representative REUSS. Before we get to that, I would like to accuse you, although in a friendly way, of being a mighty poor minimizer of the cost to the Treasury of the national debt, because what you have advocated just now is that long terms be issued in order to repress inflation when business is good; that is what you have just said.

Well, that is when interest rates are high and you are loading up the groaning taxpayer with 30 years of 4¼-percent bonds or if the ceiling is removed, 5- or 6- or 7-percent bonds. That is an awfully poor way to minimize the debt, minimize the interest charges.

Mr. SAMUELSON. Well, I plead guilty to the general charge, although I would like to plead nolo to your description of the implications of the charge.

My own opinion or I would rather say the opinion of a good political economist, which is not quite the same thing, is that the business of the Treasury is to spend money, but only in good causes, and the Treasury should spend money on interest in the good cause of stabilization. But it should not pay an excessive cent for anything; and, so given the same degree of business cycle stabilization, let us say 4 percent unemployment steadily maintained, it ought then to choose between parts of the package which will minimize the debt; but it should not sacrifice full employment with reasonable price stability merely to minimize the cost. In fact, if you really want to minimize the cost to the Treasury, you should just print money, which is the constitutional right of the Federal Government; and if you have no thought for any other consequence why, as every monetary crank tells us, why not avoid the interest charge completely by issuing non-interest-bearing debt; namely, greenbacks?

I do not mean to accuse you of any——

Representative REUSS. Of any what?

Mr. SAMUELSON. I do not mean to say that the logic of your position of minimizing the public debt led you to the theorem that the best interest-bearing debt is no interest-bearing debt, that the whole should be financed by non-interest-bearing debt; namely, by the creation of the currency itself.

Representative REUSS. I am not one of those "populistic demagogues."

Mr. SAMUELSON. Which some future Congress transiently might be in control.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. Mrs. Griffiths.

Representative GRIFFITHS. I would like to say that I agree with you that it will not happen soon, that the Congress will give up its powers to tax. Both taxpayers and politicians would oppose giving this power to the President; the taxpayers would be afraid that he would increase taxes and the politicians would be afraid that he would lower taxes at some critical moment, for a political reason.

May I ask that you suggest for the record some economic indicators on which the power would work automatically.

Mr. SAMUELSON. Long experience in economics has made me wary of any Rube Goldberg automatic indicators which can be relied upon completely.

I have learned to oppose in the field of Federal Reserve policy gadgets such as that the supply of money should be required to increase at exactly 3 percent per year, and then we should never touch the system, and I feel in fiscal policy the same danger would occur.

There is no automatic pilot which can take over under changing circumstances and act well.

But I do have in mind a set of considerations that ought to be in any person's mind, and, for a short period, you might even attach a particular action to those indicators. They would very evidently be the level and recent rates of change of the level of unemployment; the level and rates of change of one or another of the various price indicators such as, perhaps, the gross national product implicit price deflator; the balance of payments, various aspects of the balance of payments, which are gongs and whistles to us that tell us various things.

Perhaps, Henry, you will not mind if I take issue with you in a very small way on the present situation with respect to the balance of the payments.

I should not like bankers in Europe who will take much more seriously what you say here than what I say here, to be left with the impression that you may not have cared to give them, namely, that you believe that the deficit in the balance of international payments, meaning the basic deficit in the international balance of payments, is now worsening, but rather, as your written text said, that you will have some concern as to whether there may not be some gold movements that are beginning to show themselves.

Are you of the opinion that the basic balance of payments is now deteriorating?

Mr. WALLICH. Yes. I am afraid so.

Mr. SAMUELSON. Most of the experts have been rather optimistic on the basic balance, and I have been assured by many who have had

a good batting average in the past that the whole calendar year 1961 looks at this time to show much better than any of us had anticipated, not a small deficit in the basic balance of payments but actually for it to be in balance. I take it your view is otherwise?

Mr. WALLICH. We have received some extraordinary debt repayments. That certainly is real and helpful.

Mr. SAMUELSON. These are not in the basic deficit as defined in the President's message, namely, the difference between the surplus on private current account and the Government deficit on current account and long-term private investment. That is what is referred as the basic deficit.

Mr. WALLICH. And I would say all the more so.

Mr. SAMUELSON. That is deteriorating?

Mr. WALLICH. Yes.

Mr. SAMUELSON. I want to register dissent based upon the information known to me at this time.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Do you agree that we should have a tax increase at the end of the year, the first part of next year?

Mr. SAMUELSON. No, I do not agree with the specific recommendation made by Mr. Wallich, and I must say as an academic university economist, reflecting on the matter, I approve the courageous act of the President a few weeks ago in not asking for a tax rate increase, this, in terms of the probable pattern of unemployment in the year ahead.

Mr. Wallich, I thought, when he made his recommendation, must be very optimistic indeed about the date which we would return to 4 percent on employment. But, as he amplified his remark, he is to be counted among the pessimists, because he does not think of unemployment as being reduced to the negligible level, namely 4 percent, by the middle of 1962, as some very distinguished economists have gone on record as saying, but he said, by the end of next year, give or take 6 months, and given that view, Mr. Wallich expressed a willingness to take the risk of advocating now that Congress legislate for January 1 a tax rate increase.

My own view is that the situation develops from month to month, and we learn now, and there can easily come a time when Mr. Proxmire would find me recommending a tax rate increase.

I do not think on the basis of the evidence now available to us, and in terms of the value judgments that I would think ought to be made with respect to the goals of price stability and unemployment and growth, that the time is now here, and I would like to express my dissenting view.

Chairman PATMAN. For your information, you probably did not know it, I introduced a bill that would give the President the right to raise or lower tax rates, and I never heard of any other such bill being introduced. But certainly I would not want that as a policy determination over what raises or reductions ought to be permanent.

I wanted it for a length of time, a definite length of time. In other words, if the Congress were to adjourn and had appropriated a lot more money, and times were good, the President would have the right to raise taxes to balance the budget. If times were really good he would pay something on the national debt. But the Congress, when it comes back here, could handle it any way it desired.

It could either repeal the President's executive order by a joint resolution or to confirm it, or to change it in any way that the Congress should see fit.

Mr. SAMUELSON. I completely agree with that, and I could not envisage Congress doing this except under safeguards such as set by joint resolution; they could have a string on it.

Chairman PATMAN. That is right. Congress would have its hands on the purse strings.

Mr. SAMUELSON. I would say that the Commission on Money and Credit Recommendation turns out to be rather a weak one because of the 60-day period in that, and fiscal experts have told me that it is not at all clear that we would be ahead of the game in terms of the effective time in which Congress can already act by having such anticlimactic recommendations to go into effect. But we certainly want to evolve into this very slowly, and I just want a breach in the dike, an opening wedge toward something that I think is very much in the country's interest.

Chairman PATMAN. I know the argument about not delegating the power to the Executive, and the Congress should have the purse strings at all times.

I remember we were celebrating the sesquicentennial in 1937, and Chief Justice Hughes at that time was making a speech in the House of Representatives to a joint session. There was lots of criticism in the press, you know, about packing the Supreme Court and things like that, and the Chief Justice, Chief Justice Hughes, said, in effect, "that you gentlemen have charge of the purse strings."

In other words, he is saying, "Now, you appropriate the money for the Supreme Court, you can do anything with it you want to. You appropriate the money for the executive branch, you can do anything with it you want to, so you are the masters. You are in charge of the purse strings."

That is the reason why I am opposed to changing the term of a Representative to 4 years, from 2. By having it 2 years, the people, if there is a bad trend in their Government, or if they want to change it, they can do it every 2 years by electing an entirely new House of Representatives. That is certainly long enough for them to go, and I certainly hope that that 2 years is never changed because it gives the people an opportunity every 2 years to elect or not elect the people who have charge of the purse strings and the running of their Government.

Did you say you wanted to make a statement a while ago, a comment or have you already made the comments you wanted to make, Professor Samuelson?

Mr. SAMUELSON. I know of no comment I now want to make.

Chairman PATMAN. Do you have any other comment to make, Mr. Wallich?

Mr. WALLICH. Thank you, no, Mr. Chairman.

Chairman PATMAN. You gentlemen have been very nice and we appreciate your attendance here, both of you. Thank you, sirs.

If you desire to elaborate on your testimony you may do so when you have read the transcript.

The committee is adjourned subject to the call of the Chair.

(Whereupon, at 4:35 p.m., the committee adjourned, subject to the call of the Chair.)

APPENDIXES

APPENDIX I

RECOMMENDATIONS CONTAINED IN THE REPORT OF THE COMMISSION ON MONEY AND CREDIT

This appendix prepared by the staff of the Joint Economic Committee contains a verbatim account of most of the recommendations made by the Commission on Money and Credit in its report made public on June 19, 1961. Each recommendation is here numbered separately and classified according to the hearings topic to which it is most directly relevant. Several of the proposals, it should be noted, are pertinent to more than one subject and hence are reprinted more than once.

Those recommendations which deal with related issues, not primarily involved in this set of hearings, bear an asterisk; a few unrelated recommendations are omitted.

A. INTRODUCTION

(CMC origins, purposes, composition, methods, and general description of report)

(Generally, see pp. V–X, ch. 1, and pp. 283–285 of the CMC report)

B. FEDERAL RESERVE SYSTEM

(Generally, see ch. 3 (especially pp. 81–93) of the CMC report)

1. The FRB Chairman and Vice Chairman should be designated by the President from among the Board's membership, to serve for 4-year terms coterminous with the President's.
2. The FRB should consist of five members, with overlapping 10-year terms, one expiring each odd-numbered year; members should be eligible for reappointment.
3. The FRB Chairman should be the chief executive officer of the Board, empowered to handle administrative matters. The law should be clarified to authorize the Board to delegate to Board committees, or to Board members individually, or to senior staff officers of the Board, any of its functions in the administration of its powers in regard to the supervision of the banking structure, such as the Bank Holding Company Act, the antitrust laws in regard to mergers, and applications for charters and branches. Any actions so delegated should be subject to review in the Board's discretion.
4. Occupational and geographical qualifications for Board members should be eliminated. Instead the statute should stipulate that members shall be positively qualified by experience or education, competence, independence, and objectivity commensurate with the increased responsibilities recommended for them in the achievement of low levels of unemployment, an adequate rate of economic growth, and reasonable stability of price levels in the economy. Salaries of top officials throughout the Government should be sharply increased, and in view of the gravity of their responsibilities, FRB members should be compensated at the highest salary level available for appointive offices in the Government.
5. The present statutory Federal Advisory Council should be replaced by an advisory council of 12 members appointed by the Board from nominees presented by the boards of directors of the Federal Reserve banks. At least two nominations, not more than one of them from any single sector of the economy, should be presented by each bank. The Board should make its selection,

one from each district, in such a manner as to secure a council broadly representative of all aspects of the American economy. Council members should serve for 3-year terms, not immediately renewable. The council should meet with the Federal Reserve Board at least twice a year.

6. An important internal source of advice should be further recognized and strengthened. The law should formally constitute the 12 Federal Reserve bank presidents as a conference of Federal Reserve bank presidents, to meet at least four times a year with the Board, and oftener as the Board finds necessary.

7. The determination of open market policies should be vested in the Board. In establishing its open market policy the Board should be required to consult with the 12 Federal Reserve bank presidents.

The determination of the rediscount rate (the same for all Reserve banks) should be vested with the Board. In establishing this rate the Board should be required to consult with the 12 Federal Reserve bank presidents.

The determination of reserve requirements should continue to be vested in the Board. In establishing these requirements the Board should be required to consult with the 12 Federal Reserve bank presidents.

8. The Commission recommends that the present form of capital stock of the Federal Reserve banks should be retired. Instead, membership in the System should be evidenced by a nonearning certificate of, say, $500, the same for each member bank.

9. Although there is no easy solution to this issue, the Commission believes that the Federal Reserve should follow the general rule that the public should be kept informed with reasonable promptness and with reasonable detail of the reasons for its major policy decisions and actions in order to avoid misunderstanding and misinterpretation.

10. The Commission recommends that all insured commercial banks should be required to become members of the Federal Reserve System.

11. The Commission recommends that there be no extension of direct Federal Reserve controls over nonbank financial institutions.

12. The Commission recommends that the demand deposit reserve requirements for al member banks be made identical and that the classification of banks into country banks and Reserve city banks be eliminated.

C. Monetary Policy

(Generally, see ch. 3 (especially pp. 46–81) of the CMC report)

13. The Commission urges that the average rate of growth of the money supply should be consistent with the continued maintenance of high employment at stable prices and adequate economic growth, but it recognizes that it may be appropriate for the money supply to grow more or less rapidly than the output of the economy at high employment.

14. The Commission recommends the continued use of open market operations as the normal or usual instrument of general monetary policy. Instead of relying on a "bills only" policy, the Federal Reserve should be willing, when domestic or international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varied maturities. This recommendation does not mean a return to a pegged structure of prices and yields for Government securities. And the normal use of open market operations in bills to carry out technical and seasonal changes in bank reserves is appropriate.

15. The Commission concludes that the discount facility should be retained as a source of temporary credit. The Federal Reserve should provide liquidity directly to the commercial banks in times of general or regional economic distress. The Commission urges that the banking system be assured this will be done.

16. The Commission recommends that a fully discretionary, uniform rediscount rate be established for all Federal Reserve banks.

17. Clearly the intent of the Federal Reserve Board is to have discount administration relatively homogeneous among the 12 Federal Reserve banks, and the Commission urges continued efforts to assure uniform standards of discounting practice. Uniform standards, of course, mean that like circumstances result in like treatment, at the same time permitting differences in practice where regional differences in economic conditions or needs require.

18. The Commission believes that the power to change reserve requirements should be used only sparingly and favors major reliance on the use of open market operations for countercyclical adjustments.

19. The present general form of fractional reserve requirements against net demand deposits is adequate for the purposes of general monetary policy and the Commission recommends that it be continued.

20. The Commission recommends that Congress continue to grant to the Federal Reserve Board a range within which reserve requirements can be set for demand deposits, perhaps from 8 to 18 percent, so that the Board can adjust the specific level to meet the needs of growth or to meet emergency needs.

[12]. The Commission recommends that the demand deposit reserve requirements for all member banks be made identical and that the classification of banks into country banks and Reserve city banks be eliminated.

[10]. The Commission recommends that all insured commercial banks should be required to become members of the Federal Reserve System.

[11]. The Commission recommends that there be no extension of direct Federal Reserve controls over nonbank financial institutions. (Also listed under Federal Reserve System.)

D. Fiscal Policy

(Generally, see ch. 5 of the CMC report)

21. The Commission examined a variety of changes in the existing tax structure aimed at increasing its strength as an automatic stabilizer and came to the conclusion that no changes in the tax structure that would result in substantial gains for automatic stabilization are feasible.

22. The Commission believes that a strengthening of the existing degree of built-in stabilization would be desirable. This increase cannot be provided to any significant degree by changes in the structure of taxes or expenditures of the conventional sort. A promising approach that merits detailed investigation is formula flexibility wherein changes in the first-bracket rate of the personal income tax would be made automatically in response to changes in appropriate economic indicators.

23. Discretionary fiscal policy requires speed of decision and effect and can only be successful if temporary and reversible fiscal changes for stabilization purposes are dissociated from permanent and structural changes. Techniques should be developed by which taxation and expenditure policies can be applied more flexibly, and the first step in this direction lies in a sharp demarcation between shortrun cyclical changes and longrun structural changes.

24. The tax structure and expenditure programs do change from time to time and must be changed periodically as the growth of the economy alters the tax revenue—expenditure relationship. The periodic reassessment of the relationship between tax revenues and expenditures is necessary. When reassessment indicates the need for changes, it would be helpful for stabilization purposes if these basic changes could be timed to coincide with stabilization needs. However, stabilization policies and programs must not be dependent on basic changes in tax and expenditure programs.

25. The Commission therefore concludes that when discretionary tax adjustments are used to promote shortrun economic stabilization, they should consist of variations in the first-bracket rate of the personal income tax.

26. (1) One obstacle to stabilizing tax policy has been the failure to disassociate temporary and reversible changes for stabilization purposes from permanent and structural changes. It is the Commission's view that techniques must be developed by which tax policy can be applied more flexibly, and that the first step in this direction lies in the separation of shortrun cyclical tax changes from longrun structural changes in the tax system.

(2) Among various alternative taxes, the personal income tax lends itself best to countercyclical variation, and adjustments in the first-bracket rate are recommended as the best type of change.

(3) In order to provide maximum flexibility for stabilizing tax changes, the Commission recommends that Congress grant to the President limited conditional power to make temporary countercyclical adjustments in the first-bracket rate of the personal income tax, the grant to be accompanied by the following qualifications and safeguards:

(a) The power should be available for exercise only when the President has issued a statement that in his judgment economic conditions are running significantly counter to the objectives set forth in the Employment Act as amended. (See ch. 10 for details of this procedure.)

(b) The range of permissible adjustment should be limited to 5 percentage points upward or downward; that is, one-quarter of the present 20-percent rate.

(c) The duration of the adjustment should be limited to 6 months subject to renewal by the same process, unless Congress acts sooner by law to extend or supplant it.

(d) The exercise of the conditional power by the President should be subject to a legislative veto by a concurrent resolution of both Houses of Congress before any tax adjustment takes effect, in accordance with the procedures made familiar by the recent reorganization acts. To this end the President should be required to lay before the Congress any proposal to adjust the tax rate, the proposal to lie there up to 60 days, unless a concurrent resolution of disapproval is sooner voted on and rejected, and to take effect only if no such resolution is adopted in that time. In the same law that authorizes the adjustment, the parliamentary rules of the two Houses should be amended ad hoc in a manner to insure that a concurrent resolution of disapproval may be introduced and voted upon within a 60-day period.

27. (1) There should be more adequate planning for postponable projects; suitable expenditure programs should be enacted for a number of years so as to permit greater executive flexibility in timing.

(2) For countercyclical expenditures, projects and programs should be initiated or expanded only if these expenditures are essential and useful and if the length of the project as well as its time pattern are appropriate. To combat a recession, a high ratio of spending in the early period relative to subsequent periods would be favorable.

(3) Changes in planning and budgeting techniques would help to make expenditure policy more flexible. The possibility of advance appropriations for public works programs should be considered.

(4) Efforts should be made to provide incentives for State and local governments to modify their public expenditure program in a countercyclical direction.

28. A proper appraisal of the role of budget policy in economic stabilization requires that the Federal budget be presented in several different ways:

(1) The present conventional or administrative budget and the cash consolidated budget need to be supplemented by a budget as it will be reflected in the national economic accounts.

(2) The significance of changes in tax and expenditure policy should be presented in the budget under the assumption of a high-employment level of income and reasonable stability of the price level.

(3) Information should be given which will show the impact of public expenditures on an order basis.

29. The Commission recommends that when economic conditions are such that unemployment is at minimum levels and when growth may be accelerated merely by raising the supply of new investable funds through increased private saving or a larger Government surplus used for debt retirement, primary reliance should be placed on increasing the Government surplus rather than on drastic change in the tax structure required to accomplish an equivalent result.

30. When economic conditions are such as to require a higher level of consumption, primary reliance should be placed on reducing the level of tax rates rather than on changes in the composition of the tax structure.

31. The Commission recommends that, in order to establish priorities and to conduct an efficient program, Congress should explore which expenditure programs are of particular importance to growth and enact a program of such capital expenditures on a 5-year basis. The review of public capital formation must include the State and local level. Indeed, a comprehensive program for public capital expenditures cannot be developed without a fresh look at the appropriate division of responsibilities between the various levels of government and the interrelation of the revenue sources.

32. (1) Technical progress has been a major source of economic growth in the past, and public policy has made a major contribution to the growth of research in the past decade. Vigorous policies to promote technical progress should be encouraged. At the same time programs need to be developed to share the costs of adjusting to technical change.

(2) Looking ahead, high priority should be given to budgetary provision for basic research and the training of research talent. Such aid should be placed on a sustained basis, and it should play a key role in the Government's contribution to higher education.

E. Debt Management and Government Securities Market

(Generally, see ch. 4 of the CMC report)

33. The Commission concludes that none of the difficulties posed by the existing debt are so great as to justify giving priority to a policy of debt reduction if such a policy would interfere with a stabilizing fiscal polcy. A gradual reduction in the debt can be effective as a stimulant to sustainable economic growth, however, if combined with other measures which maintain low levels of unemployment and reasonable price stability. In short, the debt should be permitted to fluctuate in response to the policies required for economic stability and growth.

34. The Commission concludes that sound debt management requires that we arrest the shortening of the outstanding publicly held marketable debt which has occurred since the end of World War II. The Treasury should pursue a program which, over a period of time would lead to a more balanced maturity structure for the debt.

35. The Commission concludes that once the shortening of the debt structure is arrested, management of the marketable debt can and should make some contribution to stabilizing the level of economic activity. However, the primary responsibility for achieving this objective must be borne by monetary and fiscal policy.

36. It is the Commission's view that the transition to a more balanced debt structure may be made more safely when general economic conditions are such that restrictive action is needed on balance.

37. The Commission recommends that the Treasury take measures to expand the proportion of the public debt in the form of savings bonds on terms which are competitive with yields of suitable alternative forms of investment for small savers.

38. Accordingly, the Commission does not favor so drastic a method as consolidation of the Treasury and the Federal Reserve as a means of coordinating debt management and monetary policy.

39. The Commission favors broadening the range of discretionary debt management authority exercised by the executive branch of the Federal Government. Specifically, it recommends the abolition of the debt limit, the elimination of the interest rate ceiling, and the same tax treatment for reofferings as for outstanding securities.

40. The Commission recommends that the Treasury continue to experiment with the use of the advanced refunding technique.

41. Although the auction technique reduces the Treasury's control over allotments, less reliance upon administrative pricing is desirable. The Commission recommends, therefore, that the Treasury should continue to experiment further with the use of the auction technique.

42. Although the Commission does not favor broad authority over margins for the secondary market in Treasury securities along the lines of regulations T and U as applied in the stock market, it does urge, however, that minimum margins, such as now set by the New York Stock Exchange and the Comptroller of the Currency, be applied by various supervisory authorities to presently nonregulated lenders, including nonfinancial corporations.

F. Private Financial Institutions

(Generally, see ch. 6 of the CMC report)

43. The Commission's recommendations seek to reconcile partially conflicting objectives. One strand seeks to preserve and increase the safety of the financial system. The other seeks to provide greater flexibility for portfolio investment, increased mobility of funds, and increased alternatives for both savers and borrowers as means to stimulate economic growth. The Commission strongly believes that both objectives must be fulfilled simultaneously and stresses that the recommendations are interrelated.

44. The Commission recommends that restrictions on financial institutions which prevent or impede lending over a wider geographical area than at present should be liberalized and that State laws restricting interstate lending, on sale and leasebacks and mortgages be eased to encourage the free flow of funds.

45. The Commission recommends that Federal charters be made available for mutual savings banks.

46. The Commission recommends:

(1) The provisions of the National Banking Act should be revised so as to enable national banks to establish branches within trading areas irrespective of State laws, and State laws should be revised to provide corresponding privileges to State-chartered banks.

(2) In exercising this power to grant branches, the chartering authority should adopt the following practices:

(a) It should avoid undue concentration of the local market.

(b) It should give new entrants a chance to compete even if their business must be partially bid away from existing competitors, and should place considerable reliance on the applicant's integrity, managerial competence, and his judgment in regard to the earning prospects of the new branch.

(c) It should treat the applications for new branches on a par with new unit bank applications.

(d) It should treat applications for new branches of nonlocal banks on a par with applications for new branches of local banks.

47. The Commission recommends that branching privileges recommended for national banks be made available to federally chartered mutual savings banks and savings and loan associations. State laws should be liberalized to conform.

48. The Commission recommends continuation of the present prohibition of interest payments on demand deposits.

49. The Commission recommends that the present statutes authorizing regulation of interest rates on savings and time deposits for commercial banks be revised (1) to convert the present power into a standby authority rather than continuous regulation, (2) to include under the appropriate regulatory authorities savings and time deposits and similar liabilities of savings banks and savings and loan associations, and (3) to permit differentiation among types of deposits, including those of U.S. residents and those of foreign residents. The Commission further recommends that these institutions should be subjected to maximum rates only when in the opinion of the appropriate authorities further interest rate competition for these deposits is deemed not in the public interest, and that when applied, consideration be given to maintaining appropriate but not necessarily identical interest rate maximums for competing institutions.

Prohibiting the payment of interest on demand deposits and permitting it on time and savings deposits requires a precise definition of each type of deposit if the difference in treatment is to be equitable. Regulation Q of the Federal Reserve Board defines demand deposits precisely. The definitions for time and savings deposits are less specific, and both are tending to become more and more like demand deposits.

50. The Commission recommends that Federal deposit insurance for all savings banks and savings and loan associations be available from the Federal Savings and Loan Insurance Corporation, and that chartering authorities urge such participation.

51. The Commission recommends that membership be made more attractive for all eligible thrift institutions.

52. The Commission recommends that the regulatory authorities be authorized to permit greater flexibility to savings banks and savings and loan associations to acquire a wider range of suitable long-term debt instruments. Commercial banks should be allowed the same flexibility in investing their time and savings deposits. Financial institutions should be permitted to change their investment practices but they would not be obliged to do so.

53. The Commission recommends that investment in equities continue to be restricted. However, commercial banks, in the investment of their savings and time deposits, savings banks, and savings and loan associations should all enjoy the least burdensome restriction which is commonly available to any one of them.

54. The Commission recommends (1) that existing statutory reserve requirements on time and savings deposits be repealed, and (2) that, pending repeal of such requirements, those banks and competing institutions subject to these requirements be permitted to hold their required reserves in the form of either cash or Treasury securities with maturities up to 5 years.

55. The Commission recommends that commercial banks, mutual savings banks and savings and loan associations be subjected to the Federal corporate income tax in such fashion as to contribute to capital and reserve adequacy and to insure competitive equality (to the extent that the Federal tax is a competitive factor). The Commission also recommends that when reserves accumu-

lated through special tax provisions are used for purposes not intended by this special treatment, they should be subjected, as now, to the full corporation tax rate.

56. In view of the rapid postwar growth of financial institutions, however, the Commission recommends that Congress review the adequacy of existing legislation and that supervisory authorities review their existing regulations and examination procedures to insure against any unwarranted personal benefits accruing to individuals responsible for handling institutional funds, which might be associated with or derived from the use or investment of the funds.

57. The Commission recommends that an appropriate regulatory body should be given added responsibilities over private corporate pension funds. These responsibilities should include the power: (1) To study and develop appropriate standards of prudence in investment of the funds; (2) to enforce such standards; (3) to assure periodic disclosure to beneficiaries of the financial statements of the fund; and (4) to bring suit against malfeasors on behalf of the plan participants and their beneficiaries.

58. The Commission recommends that other States follow the practice of permitting "leeway" or "basket" clauses.

59. In order to avoid increasing complications of multiple-State jurisdictions the Commission recommends that overriding Federal charters and regulation to encourage uniformity of high standards should be available to insurance companies.

60. The Commission recommends increased coordination of examining and supervisory authorities. At the Federal level there should be only one examining authority for commercial banks. The Comptroller of the Currency and his functions and the FDIC should be transferred to the Federal Reserve System. The Commission also recommends that there be a unified authority at the Federal level for the examination of all federally insured savings and loan associations and mutual savings banks. The activities and standards of these two Federal authorities should be coordinated with each other and with the respective State examining and supervisory authorities.

61. The Commission recommends that existing statutory reserve requirements against savings and time deposits be repealed, and that pending repeal of such requirements, those banks and competing thrift institutions subject to them be permitted to hold reserves in the form of either cash or Treasury securities with maturities up to 5 years. (For a full discussion of this point see chapter 6.)

[11]. The Commission recommends that there be no extension of direct Federal Reserve controls over nonbank financial institutions.

[Also listed under "Federal Reserve System and Monetary Policy."].

[42]. Although the Commission does not favor broad authority over margins for the secondary market in Treasury securities along the lines of regulations T and U as applied in the stock market, it does urge, however, that minimum margins, such as now set by the New York Stock Exchange and the Comptroller of the Currency, be applied by various supervisory authorities to presently nonregulated lenders, including nonfinancial corporations.

[Also listed under "Debt Management."]

G. Federal Credit Programs

(Generally, see Chapter 7 of the CMC Report)

62. The Commission recommends the continuation of the Federal Housing Administration loan insurance programs to facilitate the flow of private funds into residential construction.

63. In order to insure the continued availability of insured loans in all areas of the country, the Commission recommends that the voluntary home mortgage credit program and the certified agency program of the Federal Housing Administration be encouraged.

64. The Commission recommends that a limited self-supporting Federal insurance program be developed and administered by an established farm credit agency for mortgage loans featuring low downpayments, long maturities, and not necessarily complete amortization. Such insurance should be available only under stringent conditions, perhaps such as (1) the farm unit should be large enough to take advantage of existing technology and provide a satisfactory level of family income under reasonably good management, and (2) adequate farm plans should be developed by the borrower.

65. The Commission recommends also a Federal loan insurance program for intermediate-term credit of 3 to 10 years to help farmers finance the acquisition of the capital assets, other than real estate, required for an efficient farm unit.

66. The Commission recommends that the FHA and VA underwriting programs be used to aid in implementing the countercyclical and price-stabilizing policies of the Government by variations in the terms of the underwritten loans and by allowing contractual interest rates to rise and fall with conditions in the mortgage market.

67. The Commission recommends that the Federal Home Loan Bank System operate its programs in close harmony with the general stabilization policies of the Government.

68. The Commission believes that the harmful effects of the ceiling rates on underwritten mortgages outweigh their automatic contribution to economic stabilization and recommends that they be abolished. The various interest rate ceilings or limitations that affect agricultural credit should also be removed.

69. Pending the development of more effective private secondary mortgage institutions, the Commission recommends that the secondary market operations of FNMA be continued and made more effective. The special assistance and market support programs of FNMA which are inconsistent with the dealer function should be operated in an entirely distinct and separate manner from the secondary market operations, preferably by a separate agency.

H. Economic Goals and Coordination

(Generally, see Chapters 2, 9, and 10 of the CMC Report)

70. The Commission concludes that all three goals—an adequate rate of economic growth, low levels of unemployment, and reasonable price stability—can be achieved simultaneously, and that they are fundamentally compatible if we do not expect the impossible for each. While conflicts may arise under certain conditions between reasonable price stability and low levels of unemployment, there are no conflicts between low levels of unemployment and economic growth, and between reasonable price stability and an adequate rate of economic growth. Moreover, monetary, credit, and fiscal measures to influence the level of demand are essential ingredients for the attainment of these goals, even though not sufficient by themselves. Both labor and management must cooperate to make our enterprise system work effectively. Other government measures are required to supplement monetary, credit, and fiscal measures.

The Commission believes that under such conditions an appropriate combination of both monetary, fiscal, credit and other economic measures should resolve potential conflicts among goals when they arise, and lead to their attainment simultaneously.

71. The Commission recommends that the Congress modernize and make consistent the legislative mandates which set out national economic goals in the two statutes that bear most directly on the field of the Commission's concern, namely, the Federal Reserve Act and the Employment Act of 1946. Identical language should be incorporated simultaneously in each to formulate the goals of a low level of unemployment, an adequate rate of economic growth and reasonable price stability as applicable to all Federal agencies administering economic programs.

72. The Commission recommends that "Economic Indicators" should be issued from the Executive Office of the President.

73. The Commission accordingly recommends that the Employment Act be amended to provide that whenever in the President's judgment the current economic situation, as revealed over a span of time in the indicators issued from his Executive Office or on the basis of other information, shows a tendency significantly counter to the objectives set forth in the Employment Act as amended, and at least quarterly thereafter for so long as the unfavorable tendency prevails, the President shall supplement his annual Economic Report with a statement setting forth:

(1) His understanding and assessment of the factors in the economy constributing to the unfavorable tendency.

(2) The steps being taken by him and by Government agencies, including the Federal Reserve System, to use existing instruments and resources available for better achieving the goals of the Employment Act as amended.

(3) Explanations for any seemingly inconsistent use being made of any of these instruments.

(4) Recommendations for any congressional action he thinks advisable.

(5) Any other comments he thinks appropriate.

74. The Commission therefore recommends that the Employment Act be also amended to provide that the Congress may, by concurrent resolution, request the President, if he has not already done so, to furnish such a statement, whenever it finds that the current economic situation reveals a tendency running significantly counter to the objectives set forth in the Employment Act as amended.

75. In sum, assuming the adoption of the changes already recommended in the Employment Act, the President will need to make suitable arrangements, congenial to him, for staff and interagency consultative machinery to assist him in discharging his expanded responsibilities. No statutory council should be created which has the effect of constricting his choice of advisers or formalizing their advice. The Commission recommends that he consider setting up an advisory board along the lines of the Advisory Board on Economic Growth and Stability, under a chairman to be designated by him, and plan its work so that weekly meetings of department agency deputies, supported by staff assistance from the Council of Economic Advisers, may culminate in periodic meetings of their chiefs in the presence of the President.

76. The Commission recommends that the President should fix a clear and continuing responsibility, perhaps in a subcommittee of the advisory board recommended above, for the direction and coordination of actions required to deal with the balance-of-payments problem, and, more generally, for the coordination of grant, loan, and trade policies as aspects of American foreign policy. To clear the way for this, the Bretton Woods Agreement Act of 1945 should be amended to enable the President to designate the chairman and membership of the National Advisory Council on International and Financial Problems (NAC) and to assign the responsibility for its staff support.

77. Accordingly, the Commission recommends that the Government Corporation Control Act of 1946 be amended so as to direct the Secretary of the Treasury, in the exercise of his clearance power over the issuance and sale of the securities of Government-owned corporations, to take into account explicitly the full range of objectives of the Employment Act as amended, and not merely debt management considerations; and that cases of disagreement be taken to the President.

[38]. Accordingly, the Commission does not favor so drastic a method as consolidation of the Treasury and the Federal Reserve as a means of coordinating debt management and monetary policy.

[Also listed under "Debt Management".]

[60]. The Commission recommends increased coordination of examining and supervisory authorities. At the Federal level there should be only one examining authority for commercial banks. The Comptroller of the Currency and his functions and the FDIC should be transferred to the Federal Reserve System. The Commission also recommends that there be a unified authority at the Federal level for the examination of all federally insured savings and loan associations and mutual savings banks. The activities and standards of these two Federal authorities should be coordinated with each other and with the respective State examining and supervisory authorities.

[Also listed under "Private Financial Institutions".]

APPENDIX II

RESEARCH PAPERS AND OTHER MATERIALS PREPARED FOR THE COMMISSION ON MONEY AND CREDIT BY INDIVIDUALS OUTSIDE THE STAFF, BY AUTHOR AND TITLE

Victor L. Andrews. Retirement Funds in the Financial Structure.
Irving Auerbach. U.S. Treasury Cash Balances and the Control of Member Bank Reserves.
G. L. Bach and Clarence J. Huizenga. The Differential Effects of Tight Money.
Harold Barger. The Origin of the Federal Reserve System and the Evolution of Monetary Policy.
B. H. Beckhart. Criteria of a Well-Functioning Financial System.
Ernest Bloch. The Federal Home Loan Bank System.
Arthur I. Bloomfield. The International Monetary System of the United States and Its Functioning.
William G. Bowen. Wage Behavior in the Postwar Period: An Empirical Analysis.
George F. Break. Federal Loan Insurance for Housing.
E. Cary Brown, Robert M. Solow, Albert Ando, and John Kareken. Lags in Fiscal and Monetary Policy.
Oswald Brownlee and Alfred Conrad. Effects Upon the Distribution of Income of a Tight Money Policy.
Deane Carson and Paul Cootner. The Structure of Competition in Commercial Banking in the United States.
Lester V. Chandler. Potentialities and Limitations of Monetary Policy.
Clifford D. Clark and Vivian Howard. Price Increases and Government Budgets.
Jerome B. Cohen. Japan: A Decade of Growth.
Jerome B. Cohen. The Financial Needs of Small Savers.
Paul H. Cootner. Speculation in the Government Securities Market.
Daniel Creamer. Estimates of Capacity and Capacity Utilization in Manufacturing: A Description and Appraisal.
James S. Duesenberry. Criteria for Judging the Performance of Capital Markets.
Robert Eisner and Robert H. Strotz. The Determinants of Business Investment, with an Investment Bibliography compiled by G. R. Post.
William Fellner. Problems of Public Finance During the Sixties.
Federal Reserve Bank of New York Staff Members: Steve Clarke, Peter Fousek, John Hein, Bruce McLaury, Frank Schott, and Walter Sedwitz. Postwar Achievements Relating to Growth, Employment, and Price Stability in Brazil, Canada, France, West Germany, Mexico, the Netherlands, Sweden, and the United Kingdom.
Karl A. Fox. Uses of Federal Credit in the Farm Price Support Programs, 1929–59.
Milton Friedman and David Meiselman. The Relative Stability of Monetary Velocity and the Investment Multiplier in the United States, 1897–1958.
Irwin Friend. Determinants of the Volume and Composition of Saving With Special Reference to the Influence of Monetary Policy.
Irwin Friend. The Effects of Monetary and Debt Management Policies on Nonmonetary Financial Institutions and Capital Markets.
Victor Gerdes. Regulatory and Other Influences on Sources of Funds to Insurance Companies.
Victor Gerdes. A Graduated Insurance Plan.
Thomas G. Gies, Thomas Mayer, and Edward C. Ettin. Portfolio Regulations and Policies of Financial Intermediaries.
James Gillies. Federal Credit Programs in the Housing Sector of the Economy: An Aggregative Analysis.
Raymond W. Goldsmith. Analysis of Postwar Capital Markets.
Leo Grebler and Sherman J. Maisel. Determinants of Residential Construction: A Review of Present Knowledge.
Leo Grebler. The Influence of Credit Policies on Housing.
Harry G. Guthmann, Donald P. Jacobs, and Eugene M. Lerner. Risk Capital in Financial Institutions.

Jack Guttentag. The Federal National Mortgage Association.
Harold G. Halcrow. Emergency Aid Credit Programs in Agriculture.
Harold G. Halcrow. Emergency Credit for Business and Financial Institutions.
Paul Y. Hammond. The National Security Council as a Device for Interdepartmental Coordination.
Dale E. Hathaway. The Federal Credit Programs for Individual Farm Development.
Dale E. Hathaway. The Organization and Administration of Agricultural Credit Programs.
Clifford Hildreth and Boris P. Pesek. Subsidies in Federal Credit Programs.
Franklyn D. Holzman. Mitigation of Inflation.
Paul M. Horvitz. Economies of Scale in Banking.
Ralph K. Huitt. Congressional Organization and Operations in the Field of Money and Credit.
D. Gale Johnson. The Credit Programs of the Farm Credit Administration.
D. Gale Johnson. Agricultural Credit, Capital, and Credit Policy in the United States.
Stewart Johnson. Statistics on Federal Lending and Loan Insurance Programs in the United States, 1929–58.
Robert A. Kavesh. A Financial Framework for Economic Growth.
E. Gordon Keith. The Impact of Federal Taxation on the Flow of Personal Savings Through Investment Intermediaries.
E. Gordon Keith. Tax Incentives for Institutions Operating in the Over-the-Counter Market.
John W. Kendrick. Concepts and Measures of Economic Growth.
Peter B. Kenen. The ABC's of Money.
Peter B. Kenen. The Costs and Benefits of Being a Reserve Currency Country.
Reuben A. Kessel. The Economic Effects of the Inclusion of Taxes in the Consumer Price Index.
C. P. Kindleberger. Flexible Exchange Rates.
Lawrence R. Klein. Empirical Aspects of the Trade-Offs Among Three Goals: High-Level Employment, Price Stability, and Economic Growth.
Fred H. Klopstock. Foreign Credit and Depository Facilities in the United States.
Fred H. Klopstock. Short-Term Capital Movements.
Clifton H. Kreps, Jr. and David T. Lapkin. Public Regulations and Operating Conventions Affecting Sources of Funds of Commercial Banks and Thrift Institutions.
Edwin Kuh and John R. Meyer. Investment, Liquidity, and Monetary Policy.
Warren A. Law. The Aggregate Impact of Federal Credit Programs on the Economy.
Warren A. Law. Types of Credit Assistance in Federal Credit Programs.
Stanley Lebergott. Unemployment Statistics for Monetary and Fiscal Policy Guidance.
H. L. Lewis. Postwar Unemployment Problems.
John Lindeman. Political and Administrative Arrangements Affecting Foreign Financial and Credit Operations.
John McCroskey. Federal Credit Programs for Small Business.
James W. McKie. Credit Gaps and Federal Credit Programs.
Jesse W. Markham. Administered Prices and the Recent Inflation.
Lee R. Martin. The Use of Federal Credit for Human Capital Formation.
Thomas Mayer. Interest Minimization as a Criterion of Federal Debt Management Policy.
Allan H. Meltzer. Monetary Policy and the Trade Credit Practices of Business Firms.
Merton H. Miller. The Corporation Income Tax and Corporate Financial Policies.
Hyman P. Minsky. Financial Crisis, Financial Systems, and the Performance of the Economy.
P. C. Mohrman. Federal Reserve Open Market Operations: Critique of the "Bills Only" Policy.
Richard A. Musgrave. Effects of Tax Policy on Capital Formation.
Arthur M. Okun. Empirical Analysis of Changes in the Supply and Composition of Money and Debt on Yields of Financial Assets.
Richard E. Neustadt. Coordination of Monetary Policy.

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Charlotte DeMonte Phelps. The Impact of Monetary Policy on State and Local Government Expenditures.
Michael D. Reagan. The Internal Structure of the Federal Reserve System: A Political Analysis.
Merrill J. Roberts. Government Credit Aids to Transportation.
Ross M. Robertson. The Growth of Financial Intermediaries.
James R. Schlesinger. Insulation of the Government Securities Market: Objectives, Techniques, and Implications.
Tibor and Anne Scitovsky. Welfare Aspects of Economic Growth, High-Level Employment, and Price Stability.
Warren L. Smith. Reserve Requirements in the American Monetary System.
Warren L. Smith. The Instruments of General Monetary Control.
Warren L. Smith. Central Banking Facilities for Nonbank Financial Institutions.
Robert L. Stein. The Collection and Interpretation of Employment Statistics.
Daniel B. Suits. The Determinants of Consumer Expenditure: A Review of Present Knowledge.
Theodore A. Sumberg. Inflation in Latin America.
Frank M. Tamagna. Experience and Lessons of Foreign Central Banking.
Lawrence E. Thompson. Income Velocity, Liquid Assets of Households and Nonfinancial Corporations, and Monetary Policy.
James Tobin. An Essay on Principles of Debt Management.
George S. Tolley. The Rural Electrification Administration.
Robert C. Turner and Joseph R. Ewers. The Emergency Aid Program of the Home Owners' Loan Corporation.
Robert C. Turner and Joseph R. Ewers. Federal Credit Programs for Community Development.
Robert C. Turner and Ross M. Robertson. Sources of Funds Available to Federal Lending Agencies.
Clark Warburton. Nonmember Banks and State Regulation Over Commercial Banks in Relation to the Effectiveness of Monetary Policy.
Lawrence L. Werboff and Marvin E. Rozen. Competition Among Financial Institutions.
J. Fred Weston and David A. Snell. An Analysis of Technical Components of Federal Credit Programs.
Elliott Zupnick. Consumer Credit.

MONOGRAPHS

The American Bankers Association.
American Mutual Insurance Alliance.
Association of Casualty & Surety Companies.
Credit Union National Association, Inc.
Life Insurance Association of America.
Mortgage Bankers Association of America.
National Association of Investment Companies.
National Association of Mutual Savings Banks.
National Board of Fire Underwriters.
National Consumer Finance Association.
U.S. Savings & Loan League.

Appendix III

ADDITIONAL STATEMENTS

(Note.—All members of the Commission on Money and Credit who could not personally appear before the committee, as well as other individuals who could not accept an invitation to appear, were invited to submit written statements. Such statements as were received are printed in this appendix.)

Statement of Earl B. Schwulst, Member, Commission on Money and Credit; Credit; Chairman, Finance Committee, Ford Motor Co.

I have no comment on the report of the Commission on Money and Credit except to say that I am generally in agreement with it except with respect to the one or two instances where I dissented in footnotes which appear in the report. This does not mean that I am completely sold on each and every one of the recommendations notwithstanding the fact that I did not comment upon or dissent from them. I think that there were a number of areas of compromise with respect to these recommendations.

To mention one point of omission in the report: I think that not enough attention was given to the concentrated power in the hands of the mass labor unions and in the hands of the major industrial corporations which are impediments to the free interplay of the demand and supply factors in the open market. The existence of this power is a handicap toward the achievement of the national goals as set forth in the Commission's report. I think that the Commission's report also failed to lay sufficient emphasis upon the importance of passing on to the consumer through price reductions (or through the omission of price increases) a part of the savings and productive processes resulting from improvements in the arts and sciences. Participation by the consumer in these savings through price reductions would be one of the best ways of keeping up consumer demand. The Commission's report places, I think, too much emphasis upon building up consumer demand through the running of the Government deficits in times of economic recession or in other times of slack consumer demand.

In general, I believe the Commission's report is constructive and that most of its recommendations merit favorable consideration by those with the power to act upon them. I think this is particularly true of the recommendations in the chapter dealing with financial institutions.

Statement of Theodore O. Yntema, Member, Commission on Money and Credit; Chairman, Finance Committee, Ford Motor Co.

I am most grateful for your invitation to comment on the report of the Commission on Money and Credit.

Our report was essentially the work of laymen, drawn from many walks of life, aided and informed by a professional staff. Most of us were not expert in most of the fields we studied. Moreover, we covered a great range of subject matter. We brought what intelligence and commonsense and experience we possessed to bear on many problems—most of them new to us.

In saying this, I do not belittle the work of our Commission. Most of us, as citizens, do not do enough such work. We cannot leave the great problems of our economy to the experts.

I do suggest, however, that the major value of the Commission's report lies in the general direction and character of its findings—not in the specific details. Its conclusion should be taken, for the most part, as suggestive rather than definitive. All the matters we dealt with require further study and discussion.

I am particularly pleased, therefore, that the report is the subject of hearings by your committee. I know these hearings will add importantly to the understanding of the problems in money and credit with which we tried to grapple.

STATEMENT OF NEIL H. JACOBY, DEAN, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UCLA

This is a brief commentary on the recommendation of the Commission on Money and Credit that the Congress delegate to the President discretionary power to raise or lower the rate of Federal tax on the initial bracket of personal income by 5 percentage points, subject to a veto of Congress. Adoption of the recommendation would give the President discretionary power to vary the present 20-percent rate—from which the preponderance of all personal income tax revenues come—up or down by 25 percent.

This proposal has been put forward on the theory that the Federal budget should serve, to the maximum extent consistent with other national objectives, as a stabilizing force in the U.S. economy. There is general agreement today on the validity of this principle. We know that the present Federal revenue and expenditure systems are such that, during a general business recession, Federal revenue receipts decline and expenditures rise, thus offsetting part of the decline in private incomes and expenditures and curbing the recession. Conversely, during an economic expansion, Federal revenues rise sharply and expenditures (notably on unemployment benefits) contract, thus moderating the rise in private incomes and expenditures, and helping prevent an inflationary boom.

Dr. David Lusher has estimated that, under the conditions of 1955 these "built-in" changes in the Federal budget would offset about 33 percent of the decline in GNP that would otherwise occur. The Federal tax rate on the initial bracket of personal income has not changed since 1955, but unemployment benefits have been enlarged considerably in both coverage and scale, so that it is likely that the automatic stabilization "built into" the Federal budget at the present time is somewhat greater, perhaps 35 to 36 percent of any future decline in the GNP.

Several questions need attention:

(1) Is the present automatic stabilization power built into the Federal budget sufficient?

(2) Is it feasible or desirable to increase the purely automatic stabilization powers of the Federal budget?

(3) How, if at all, should the discretionary authority of the President be enlarged to moderate business fluctuations?

In my opinion the present automatic stabilizing power of the Federal budget, while considerable, falls short of that which may be needed in the future. Although the Federal Government can do much to smooth out business fluctuations through flexible monetary, debt management, and other actions to stimulate or repress private demand, they operate slowly after long timelags. Federal taxing and spending actions can work more rapidly, and will have to carry much of the burden of economic stabilization. Occasions are likely to arise when the national interest will call for more powerful and rapid stabilizing actions—in either direction—than the present Federal budget automatically provides. Examples might be the outbreak of a limited war, or a business recession affecting Europe as well as America.

It is not desirable, in my opinion, to increase the purely automatic stabilizing power of the Federal budget. In theory, this could be done very simply by raising the intitial income tax rate to 25 or 30 percent, or by greatly expanding unemployment benefits. But the United States now taxes personal incomes very heavily, and should lower rather than increase the normal rate structure, when circumstances permit, in the interest of providing further incentives to production, saving, and economic growth. Moreover, Federal expenditures are not susceptible to rapid adjustments upward or downward in response to short-term cyclical changes, and unemployment benefits should be fixed with reference to the personal situations of unemployed workers.

How, then, can the Federal budget be equipped with additional stabilizing power? One method is that proposed by the Commission on Money and Credit—to give the President purely discretionary authority to raise or lower the tax rate. Another method that has been proposed is that of "formula flexibility"—to provide for automatic changes in the initial personal tax rate whenever changes in the unemployment ratio or the Consumer Price Index have passed specified critical levels. Both are subject to weighty objections.

To grant the President broad authority to change the tax rate involves two important risks: There is the risk that he will misjudge the economic situation

and make inappropriate changes. Secondly, there is the risk that a President will abuse his authority for political purposes, such as by reducing taxes in an effort to win an election. "Formula flexibility" is free of the risk of politically inspired tax changes, but it carries the risk (that any mechanical formula contains) of triggering the wrong action because of special factors not taken into account by the formula. Economic changes are so numerous, rapid, and incompletely understood that mechanical formulas need to be modified by human judgment.

I propose use of a combination of Presidential discretion and "formula flexibility" which would minimize the chances of error or abuse. While many alternatives exist and specific details should be studied carefully, the proposal is of this form: Congress will authorize the President to raise the tax rate on the initial bracket of personal income within his discretion up to 5 percentage points, provided that the seasonally adjusted unemployment ratio has been less than 5 percent during each of the preceding 3 months and the Consumer Price Index has risen by 1 percentage point or more during each month of this period.

Congress will authorize the President to reduce the tax rate within his discretion up to 5 percentage points, provided that the seasonally adjusted unemployment ratio has been greater than 6 percent during each of the preceding 3 months and has been rising and the Consumer Price Index has not risen by more than 0.5 percentage point over the preceding 3-month period.

Such legislation would provide the President with broad discretionary powers—which he would not necessarily exercise—to change the tax rate quickly. It sets up objective standards for action, yet the conditions of any changes would insure against grossly inappropriate action. Of course, the Congress would always possess unlimited power to make whatever tax changes it wished at any time.

This proposed formula, and alternatives, should be applied to the postwar U.S. economy for the purpose of determining the circumstances under which it would have made it possible for the President to act. While I have not had time available to undertake this exercise, I am confident that the results would demonstrate the positive value of this or similar legislation.

LOS ANGELES, CALIF., *August 16, 1961.*

STATEMENT OF ALLAN SPROUL, KENTFIELD, CALIF.; PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK, 1941–56

To identify myself in the manner which has become customary at hearings of the committee, my name is Allan Sproul. I am a director of the Wells Fargo Bank and American Trust Co. of San Francisco and of the Kaiser Aluminum & Chemical Corp. of Oakland Calif., and I was president of the Federal Reserve Bank of New York and vice chairman of the Federal Open Market Committee for 15 years from 1941 to 1956. In presenting my views, however, I represent no one but myself; neither the private business community, the commercial banks, nor my former associates in the Federal Reserve System.

I should also mention, I think, that I was named as a member of the Commission on Money and Credit when it was first being organized in February 1958. In preceding years I had been among those who had advocated a study of our financial system by a national monetary commission established by the Government, and composed of a small number of men competent in the field, experienced in economic matters, and with a reputation for objectivity. This official or Government commission did not come to pass. As a second choice, the private commission sponsored by the Committee for Economic Development seemed to offer a partially satisfactory means of bringing our financial machinery under scrutiny and suggesting possible ways of improving it. When I accepted appointment to the Commission in February 1958, it was to be a Commission of 15 members "chosen for their individual qualities, not as representatives of organizations or sections of the community" with a "balanced representation of philosophies and approaches." In mid-April 1958 I was advised that it had been decided that "for more ideal balance the Commission should be expanded to a minimum of 25, bringing about representation of areas, points of view, and interests which were not adequately provided for in the Commission of 15 as originally planned." I learned of the membership of the enlarged Commission by way of a press release on May 29, 1958. On June 12, 1958, I withdrew from the Commission. My resignation was announced in a press release of the Commission on January 22, 1959.

So much for identification. As you requested, I now address myself to that part of the recently published report of the Commission on Money and Credit (CMC), which has to do directly with the structure of the Federal Reserve System. In this area, at least, I suggest that the CMC, in its efforts to compromise the various points of view and interests of its members, produced a doubtful package of recommendations. Some of them are good but, in the aggregate, they represent an attempt to pacify those who would "nationalize"[1] the Federal Reserve System by destroying its Federal character, and they tend to water down the symbols of support of the System by the private financial community to the point of poisoning rather than preserving a relationship which has made successful evolutionary progress for half a century. I directly challenge, therefore, so far as the structure of the Federal Reserve System is concerned, the statement of the CMC in the introduction to its report, that it has tried to "confine its recommendations and suggestions for change only to situations where the present structure has not worked well."

What are the recommendations and suggestions of the CMC for changes in the structure of the Federal Reserve System?

1. The FRB (Board of Governors of the Federal Reserve System) Chairman and Vice Chairman should be designated by the President from among the Board's membership, to serve for 4-year terms coterminous with the President's.
2. The FRB should consist of five members with overlapping 10-year terms, one expiring each odd-numbered year; members should be eligible for reappointment.
3. The FRB Chairman should be the chief executive officer of the Board, empowered to handle administrative matters. The law should be clarified to authorize the Board to delegate to Board committees or to Board members individually, or to senior staff officers of the Board, any of its functions in the administration of its powers in regard to the supervision of the banking structure, etc. Any actions so delegated should be subject to review in the Board's discretion.
4. Occupational and geographical qualifications for Board members should be eliminated. Instead, the statute should stipulate that members should be positively qualified by experience or education, competence, independence, and objectivity commensurate with the increased responsibilities recommended for them in the achievement of low levels of unemployment, an adequate rate of economic growth, and reasonable stability of price levels in the economy. Salaries of top officials throughout the Government should be sharply increased and, in view of the gravity of their responsibilities, FRB members should be compensated at the highest salary level available for appointive offices in the Government.
5. The present statutory Federal Advisory Council should be replaced by an advisory council of 12 members appointed by the Board from nominees presented by the boards of directors of the Federal Reserve banks, etc.
6. The law should formally constitute the 12 Federal Reserve bank presidents as a conference of Federal Reserve bank presidents, to meet at least four times a year with the Board, and oftener as the Board finds necessary.
7. The determination of open market policies should be vested in the Board. In establishing its open market policy, the Board should be required to consult with the 12 Federal Reserve bank presidents. The determination of the rediscount rate (the same for all Reserve banks) should be vested with the Board. In establishing this rate the Board should be required to consult with the 12 Federal Reserve bank presidents. The determination of reserve requirements should continue to be vested in the Board. In establishing these requirements, the Board should be required to consult with the 12 Federal Reserve bank presidents.[2]

The first five of these recommendations, which I would characterize as the trimmings of this section of the report of the CMC, might be accepted, I think, as moves in the right direction.

The suggestion that the terms of office of the Chairman and Vice Chairman of the Board be made coterminous with the term of office of the President has been attacked by those who see this as an attempt to introduce partisan politics

[1] A vague general term used to frighten conservatives.

[2] In veering toward centralization of power within the Reserve System, the CMC rightly avoided the recommendation sometimes put forward that the Board as well as the Open Market Committee should be abolished, and our monetary affairs placed in the hands of a single executive. This country has shown a wise aversion to "czars," and still likes the idea of some checks and balances.

into the functioning of the Board, which is a sin we all deplore. The facts of the matter as I have observed them, however, are that the Chairman of the Board really serves largely at the will or pleasure of the President now. The Chairman of the Board is the chief point of contact between the Board and the President, the Secretary of the Treasury, the Council of Economic Advisers, and all of the most important officers of the executive branch of the Government, and only to a slightly lesser degree with the Congress. If he is persona non grata at the White House, his ability to carry out the duties of his office is so gravely damaged as to make it impractical and unwise for him to continue as Chairman. The present wording of the law concerning the term of office of the Chairman seems to me merely to mask this fact of life. I do not mean, however, that the Chairman of the Board must become a subservient political appointee; he retains the right and the duty to represent the Board fairly and forcefully in expounding its views and methods, and preserves the individual right of resignation without disloyalty to the President, or party, if he decides that his service as Chairman is no longer compatible with the economic policies being followed by the Government.

A reduction in the number of members of the Board from seven to five, and in the terms of office from 14 to 10 years, with eligibility for reappointment, should make a modest contribution to improving the quality of the Board membership. And, as the report of the CMC says, it is a suggestion which retains stability of membership, protects independence in expressing views and advocating policies which may not be popular, and provides some safeguard against superannuation.

The recommendation that a means be sought to make clear that the Board, as a whole, is not to be enmeshed with routine administrative matters, to conserve its members' time, and to arrange for the more expeditious disposition of its caseload of business, has merit. The success of the suggestion is bound up, however, with questions of the qualifications for Board membership, the size of the Board, and the extent to which the individual members participate with the Chairman in working out coordination of monetary policy with the general economic policies of the Government. One reason for the implied "congestion of detailed business at the top" at the Board, is the druglike attraction of such business when sitting in your office pondering the broad issues of monetary policy becomes tedious.

There is no question in my mind that the present occupational and geographical qualifications for Board members have outlived whatever sound purpose they ever had. They represent an embryonic phase of thinking concerning the role of a central banking system in this country. The general statement of qualifications suggested by the CMC is much more in tune with the responsibilities of the Federal Reserve System, present or proposed, and with the need to abandon ideas of finding effective national monetary policies in an atmosphere of representation of special interests. The companion recommendation of increased salaries for Board members has become a standard item in all considerations of the membership of the Board. The consistency with which this recommendation has been ignored by the executive and legislative branches of the Government suggests that there is a roadblock to its acceptance which does not have to do with the specific merits of the recommendation.

The suggestion of the CMC concerning the Federal Advisory Council appears to be an attempt to rescue from possible eventual extinction a body which was established in the early days of the Federal Reserve System as a sop to the bankers who had been ruled off the Board on the theory that you don't make game wardens out of poachers. Although the Board can seek advice from whatever individuals or groups it chooses under its general powers, there is some merit in retaining a statutory body, outside the Government and the Federal Reserve System, with which the Board must consult from time to time, and which has statutory authority to ask questions, seek information, and proffer advice. I do not think, however, that it is necessary or desirable to change the method of election of members of the Federal Advisory Council. What is necessary and desirable is to smash the tradition, growing out of the early history of the System, that the members of the Council elected by the boards of directors of the Federal Reserve banks should be commercial bankers. Relieved of this anachronism, the boards of directors of the district banks are much better able to select representatives of their districts than is a board at Washington, and the privilege is a desirable one in the relations between the Board and the districts. Turning the present election process around, so as to make the Board the final appointing authority, seems to me to be a picayune obeisance to an obsession with what the CMC calls the influence of the "private base" of the System.

Now we begin to get down to the meat in the coconut. The recommendation that the law should formally constitute the 12 Federal Reserve bank presidents as a conference, to meet at least 4 times a year with the Board, is an unnecessary and spurious attempt to seem to increase the stature of the presidents of the Federal Reserve banks, who are to be deprived of their most important function by the next recommendation of the Commission. The conference of presidents of Federal Reserve banks has been in existence for years; it meets regularly to discuss matters of credit policy and Federal Reserve administration; it consults with the Board as a necessary corollary of their joint responsibilities. The sanctions of tradition and long practice have given it a place and stature in the working of the Federal Reserve System, to which statutory recognition can neither add nor detract.

Having paid a left-hand compliment to the presidents of the Federal Reserve banks in this recommendation, the CMC in its next recommendation relegates them to the role of branch managers by proposing that all of the main powers of the System in the field of monetary policy should be lodged in the Board, with only advisory participation by the presidents of the Reserve banks. It does this, first, on the ground that these powers—determining rediscount rates, deciding open market policy, and fixing reserve requirements—"should be complementary and governed by the same considerations, that is by the same people in the same forum." And, second, the CMC says that the exercise of these powers belongs exclusively in the hands of public officials; that is, the Board, and that there should be no ambiguity about where this responsibility lies.

The Commission is right, of course, in saying that these powers should be and are complementary, and it is right in saying that they should be exercised by public officials, but the fog of compromise evidently concealed from the Commission the logical suggestion, based on successful experience, that the place to lodge these complementary powers is in the Federal Open Market Committee (as it would be constituted on the present formula, if the size of the Board were reduced from seven to five members). The Federal Open Market Committee has become the heart of the Federal Reserve System; cut it out and you have a skeleton. It is a unique development in central banking which has evolved out of the experience of the System with the needs of a country of the size and character of the United States.[3] It is made up of men having statutory responsibilities, who serve on the Committee as individuals under law, and who are public officials and public servants in every real sense. Finally, the present constitution of the Federal Open Market Committee observes the cardinal principle of central banking that those who determine monetary policy should not only coordinate their actions with the general economic policies of the Government, but should also have a direct contact with the private money market—a contact which comes from living in the market, operating in the market, knowing the people in the market, and being able to feel the pulse of the market by hand from day to day, and not by random telephone calls or by reviewing cold statistics.

Here, I think, is a tender point with some members of the joint committee and indeed of the whole Congress, and with some people in the Federal Reserve, but it cannot be avoided. The first and most direct point of contact between the policies of the monetary authorities and our national and international monetary systems is the New York money market. This is no device of greedy men and no accident of geography which can be changed by legislative fiat. It reflects the necessity, in a money economy such as ours, of having a marketplace where the final and balancing transactions of our national and international accounts can be carried out by a variety of delicately constructed financial institutions. And the operating arm of the Federal Reserve System in the principal money market of the Nation, and of the world, is the Federal Reserve Bank of New York. The Banking Act of 1935 recognized that inescapable fact, and the need for a living link between monetary policy and the money market, by requiring that the president of the Federal Reserve Bank of New York must be a continuing member of the Federal Open Market Committee. All Federal Reserve banks are equal, but the Federal Reserve Bank of New York is first among equals.

I can only surmise why the CMC decided that the Federal Open Market Committee should be dismantled. The statement that the "distinction between the

[3] This argument should not be confused with the ideas prevalent in the early days of the Reserve System concerning regional differences in monetary policy. Monetary policy must be national, except in minor degree, but the whole is still the sum of its parts, and regional conditions are important in formulating national policy.

Board and the Federal Open Market Committee has outlived its usefulness" raises questions, but answers none. From the language of other sections of the report, I would guess that those members of the CMC, who might have argued for the retention of the Federal Open Market Committee if they had known more about it, were lulled into acceptance of its abandonment as a "package deal" by those who were united in promoting the idea that private influence still permeates the Federal Reserve System, and must be eliminated if the System is to discharge its public functions properly and merit the complete confidence of the Government and the Nation.

The report first constructs a neat word pattern to describe the structure of the Federal Reserve System, and it then states that a basic issue concerning the System is the "degree of independence of the Federal Reserve * * * from the banking community which it both serves and regulates."

It is my view that the word pattern—a System with a regulated private base, a mixed middle component, and a controlling public apex—is neat, but inaccurate. In all of its operations in the area of monetary policy I assert that the Federal Reserve System (Board and Reserve banks) is a public institution, as it must be to discharge the public functions vested in it by the Congress. Clearly, the Board is a public body. It is equally clear to me that the Federal Open Market Committee, on which the presidents of the Federal Reserve banks serve, as individuals, by statutory appointment, is a public body and not a "mixed middle component." The report of the CMC seems to rest its contrary view on the statement that the presidents of the Federal Reserve banks are not Government appointees, but are elected by and have their compensation fixed by the boards of directors of their banks, subject to the approval of the Federal Reserve Board. If the Commission had pursued this lead further, it would have known that approval by the Board of appointments and salaries of presidents of Reserve banks is not a perfunctory power. The Board has demonstrated on numerous occasions that it is an active veto power, so that there is final public control. But this is more quibbling with words than meeting the real issue. The real answer is that you do not achieve honesty and integrity and unswerving devotion to the public interest by way of appointment procedures, but by charging competent men with an undivided responsibility for public service. That is the case with respect to the presidents of the Federal Reserve banks as they serve by statutory appointment on the Federal Open Market Committee. They have no allegiance to private business in these matters, except as they try to contribute to the attainment of high level production and employment, sustainable economic growth, and a stable price level by monetary means.

The report of the CMC goes on to fill out its pattern of the "public-private category" within the Federal Reserve System with a brief discussion of the Federal Reserve banks, but it quickly admits that "very tangibly as well as legally the Reserve banks are public service institutions, and that their private 'ownership' is a highly attenuated right." In a rather odd "on the other hand" the report goes on to say, however, that the salaries of Reserve bank presidents and their staff salary scales are set at going market rates rather than Government levels"; the Reserve bank presidents are not public servants in the usual sense." In my book this is no more than pandering to confused public ideas about conflict of interest. The salaries of Federal Reserve bank officials and staffs are set at going market rates so that the banks can attract the quality of administrators and personnel needed to assure the qualities and services necessary for constructive participation in determining monetary policy, and efficient operation, in the communities in which they live. I would say that it is fortunate and in the public interest that they are able to do this, so that numbers of capable, competent men can make a career of service in the Federal Reserve System, away from the hazards of political appointment, without the support of family or personal wealth, and without engaging in outside activities of any kind to supplement their regular compensation. There is no entering wedge for conflict of interest here.

The only specific suggestion which the Commission makes concerning the Federal Reserve banks is that the present form of stockownership of the banks should be retired, and that membership in the System be continued by a nonearning certificate of, say $500, the same for each member bank. This seems to me to be knocking down an already "attenuated" strawman, insofar as it represents a belief or a suspicion that somehow private interests have a nefarious influence in, or derive special benefits from, the Federal Reserve System. As my previous remarks have indicated, however, I would be concerned if insistence upon the present form of stockownership were to be interpreted as

supporting such belief or suspicion. I would rather have the stock subscription changed to a certificate of membership than to have any cloud over the character of the Reserve banks as public institutions.

There is one other point here that is worth mentioning, however. I have referred to the statement in the report of the CMC that a basic issue with respect to the Federal Reserve System is its degree of independence from the banking community which it both serves and regulates. This statement tends to confuse the monetary powers of the Federal Reserve System and its bank supervisory powers. In discharging its duties as a bank supervisor the Federal Reserve System may be a Government agency with an agency-clientele relationship with the business concerns it both serves and regulates, in the words of the Commission, but in the vastly more important realm of monetary policy the Federal Reserve has no agency-clientele relationship with any one but the American people as a whole. If the bank supervisory powers of the Federal Reserve System are the reason for concern about the "ownership" of the stock of the Federal Reserve banks by the member banks, consideration should be given to consolidating the regulatory functions of Federal banking authorities outside the Federal Reserve System, as suggested in a footnote by some members of the CMC. The "regulated private base" of the System (the commercial banking system), in the word pattern of the Commission, is not the base of the System as a monetary authority. It is the private monetary mechanism which serves as a channel through which the monetary actions of the System spread out through the whole community, pervasively but without unnecessary intrusion upon private transactions between citizen and citizen.

Now let me close by coming back to the question of the Federal Open Market Committee, which is by far the most important question to which the CMC addressed itself in the section of its report on the structure of the Federal Reserve System. I do not believe that many of the members of the Commission realized the full import of what they were doing when, actively or passively, they acquiesced in recommending that the Federal Open Market Committee be abolished. I have said it is the heart of the Federal Reserve System as it has evolved over the years, and it is. It is the forum where representatives of the constituent parts of the System—the Reserve Board and the Reserve banks—meet as individuals and equals, bearing identical responsibilities under law to decide questions of high monetary policy. It is the group within the System which brings to the consideration of policy, knowledge of what is going on in Government, in the money market, and in commerce, industry, and agriculture throughout the country.[4] Its members take back to the Government, to the money market, and to the country, an understanding of what has been decided which is an essential ingredient of effective monetary policy.

I have said that if you remove the presidents of the Federal Reserve banks from continuous (in the case of New York) or periodic (in the case of the others) participation in this high function you will tear down the spirit and morale of the 12 banks, and I believe it. The men who are the most capable and imaginative officers of Federal Reserve banks, and who staff their outstanding economic research departments, are not primarily interested in counting coin and currency, in sorting checks, and in examining member banks. They and their successors won't be attracted to jobs in which these operating chores are their only direct and primary responsibility; jobs in which they are only called upon as consultants and advisers in matters of monetary policy. Participation in the work of the Federal Open Market Committee, with authority and responsibility—the right to vote as well as to talk—is what attracts the best men to the chief offices of the Federal Reserve banks, and it is this contact which fills their official staffs with a sense of dedication and high purpose.

I sincerely hope that the Congress of the United States will never reverse itself on this important matter. I sincerely hope that it will go forward to complete the ingenious work of the Banking Act of 1935, by combining in law in the Federal Open Market Committee the complementary powers of the Federal Reserve System with respect to open market operations, rediscount rates, and reserve requirements.

Thank you for giving me this opportunity to present my views to your committee.

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[4] This form of words does not exclude labor or the consumer or any other group within the body economic, although organized labor has ordinarily been suspicious of the Reserve System, and has generally refused to become better acquainted, even when invited to do so.

ADDITIONAL STATEMENT OF DAVID ROCKEFELLER

AUGUST 24, 1961.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JAVITS: At last Thursday's Joint Economic Committee hearings on the report of the Commission on Money and Credit, you suggested that I might write you about some of the Commission's views on international economic matters. On that occasion, you posed three specific questions: What must the United States do to achieve a viable position in its international payments? Are U.S. exporters being generally priced out of world markets? What do recent international economic developments imply for U.S. trade policy?

These are all exceedingly important and broad questions. Not all of them were dealt with specifically by the Commission because of its focus on financial matters. However, I should be glad to give you some of my own views on these subjects, and I am attaching a copy of my statement before the Joint Economic Committee's Subcommittee on International Exchange and Payments. This statement is addressed to the problem of international liquidity.

In my opinion, the United States cannot relax in its efforts to achieve a lasting solution to its balance-of-payments problem. While our situation improved dramatically in the first half of this year, temporary factors explain much of this improvement. Exports were stimulated by the boom in Western Europe and Japan, while imports were held down because U.S. business was just moving out of a recession. In addition, special advance payments of debts by Western Germany, the Netherlands, and the Philippines totaled $650 million. The rapid recovery in U.S. business activity now underway can be expected to generate increasing demand for imports, while any leveling in the rate of advance in Western Europe and Japan could make it difficult to increase our exports. Thus, we could again find ourselves in balance-of-payments difficulties.

The most constructive approach to this problem lies in steps to increase U.S. exports. A fundamental problem in doing so is to keep our costs in line with those in other industrial nations so that we can compete effectively. The available statistics, plus actual trends in our trade, lend little support to the argument that we are already priced out of world markets in a general sense. However, it is clear that we have lost our competitive advantage in a number of specific products. If we are to regain our position in these markets, costs and prices will have to be reduced. And we must contain any tendency toward cost inflation in products where we are now competitive.

In addition, U.S. exporters of capital goods have found themselves at an increasing disadvantage because of lack of effective arrangements to provide medium-term export credits. Exporters in other nations have been able to offer such credits for 1- to 5-year terms under direct government, or government-supported, programs. The U.S. commercial banks active in the international field already have a substantial oversea exposure on short-term credits and could not prudently assume the substantial political risks involved in medium-term financing. While the Export-Import Bank offered medium-term export financing, its procedures were necessarily time consuming and it lacked the necessary close-working relationships with the many thousands of exporters involved.

A number of efforts are underway to provide medium-term export credits in a manner that will place our capital goods exporters on an equal footing with those in other nations. The export-Import Bank has been working with commercial banks and insurance companies to develop cooperative arrangments to handle the commercial and political risks inherent in such credits and to provide the necessary financing.

We at the Chase Manhattan Bank have developed a program which we believe would bring together the talents and resources of the private financial community and those of the Export-Import Bank in a manner that would prove most effective and efficient. Under this plan, a commercial bank with experience and resources in the international field would handle the function of checking credits and processing the necessary documents and would assume a substantial part of the commercial risks for up to 18 months on any transactions. The exporter would also take a portion of both the political and commercial risks and provide part of the financing. The Export-Import Bank (or a group of casualty

insurance companies working with the Export-Import Bank) would issue insurance covering the bank's portion of the political risk and the total risks involved in the portion of the credit not held by the bank and the exporter. The commercial bank would set up a new Edge Act subsidiary (an export credit organization) which would purchase and hold the portion of the credit which is fully guaranteed. The export credit organization could then issue its own obligations, fully backed by insured medium-term paper, and these would be appropriate investment outlets for life insurance companies, savings banks, and pension funds. In this manner, the flow of long-term savings would be mobilized to provide a major part of the financing for capital goods exports. We have submitted this proposal to Export-Import Bank officials who have indicated their general approval.

To turn now to your question about U.S. trade policy, I should like to restate my belief that the Nation should continue to pursue the objective of reducing and removing barriers to the flow of trade among nations. I believe our balance-of-payments problems can best be dealt with in the framework of an expanding and dynamic world trade. Moreover, we must be in a position to bargain with such regional groupings at the European Economic Community, which will be significantly strengthened if the United Kingdom and other nations become members, to reduce the barriers imposed against U.S. exports.

To pursue this broad objective in the 1960's will call for genuine imagination and vision. While I have not studied the technical problems, it may well be that we shall have to develop new approaches to trade policy and to negotiation with common market groupings. And I believe we must find ways to facilitate the necessary adjustments within our own economy in order that workers and industries affected can find attractive opportunities in other fields. All of this poses difficult challenges, but challenges which must be met if we are to fulfill our responsibilities of leadership in the free world.

It is difficult in a brief statement such as this to deal adequately with broad problems of international economic policy. However, I hope you may find this statement of value, and I want to thank you for the invitation to submit my views.

Sincerely,

DAVID ROCKEFELLER.