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THE PRESIDENT'S ECONOMIC REPORT

THURSDAY, FEBRUARY 25, 1965

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

The Joint Committee met at 10 a.m., pursuant to call, in room AE–1, the Capitol Building, Hon. Wright Patman (chairman), presiding.

Present: Senators Proxmire, Javits, Jordan, and Talmadge; Representatives Patman, Reuss, Curtis, and Ellsworth.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

This morning the committee is privileged to have the advice and counsel of a distinguished economist, Prof. Raymond J. Saulnier, of Barnard College, Columbia University. Dr. Saulnier holds a doctor of philosophy degree from Columbia University.

Since 1946 he has been a director of financial research for the National Board of Economic Research. From 1950 to 1952 he was adviser to the Board of Governors of the Federal Reserve System.

He became a consultant to the President's Council of Economic Advisers in 1953, was appointed member of the Council in 1956, and Chairman in 1957. At present he is a trustee for the New York Bank for Savings in New York City and is the author of numerous books on economics.

Dr. Saulnier, it is a great pleasure and privilege to welcome you again as a witness before the Joint Economic Committee. We wish to express our appreciation for your advice and counsel in matters before the committee. You may proceed in your own way, sir, with your statement, after which there will be questioning under the 10-minute rule by the members of the committee, which you are acquainted with, you having been here numerous times.

We are always glad to have you, sir.

STATEMENT OF RAYMOND J. SAULNIER, PROFESSOR OF ECONOMICS, BARNARD COLLEGE, AND FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. SAULNIER. Thank you, Mr. Chairman. My name is Raymond J. Saulnier and I am a resident of New York City where I am professor of economics at Barnard College, Columbia University.

I am here at your invitation, for which I thank you, to give you and your fellow committee members my reactions to the President's January 1965 Economic Report to the Congress and to the accompany-

ing annual report to the President by the Council of Economic Advisers.

I will, if I may, refer to the two documents jointly as the "Economic Report."

There are a good many things to say about this year's Economic Report but I can perhaps be most helpful to the committee by directing myself to the point on which I regard the report, and administration economic policy generally, as most open to criticism.

That point is international economic policy. This is not to say that I have no reservations about domestic economic policy. I have a good many, but the principal one is that at this juncture domestic economic policy is inadequately attuned to the needs of our international position.

My testimony, therefore, will be directed mainly to international economic policy and specifically to the balance-of-payments problem. Its ramifications are so many, however, and so far reaching that they will permit me to comment on virtually every major part of the Economic Report.

To state my reservations concisely, I am afraid that the Economic Report understates the gravity of the balance-of-payments problems and I feel quite sure that in its approach to this problem the administration is relying too much on measures that can give only temporary relief and which may, in the longer run, prove to be positively harmful.

I don't know why the Council chose to use the title "Approaching External Balance" for the section of chapter I of the report dealing with U.S. international payments; but, assuredly, this does not describe events in 1964. Nor does it describe the trend of events since 1960. Let me see if I can first get the facts stated simply.

I need not tell this committee that to get the facts on the balance of payments stated simply is not an easy thing to do. There are so many items, plus and minus, and they can be grouped in so many different categories and presented in so many degrees of "netness" and "grossness" it is rare that any two sets of numbers can be compared with one another.

But we must make a comparison at least between 2 years if we are to say anything about the drift of things. To this end I have first taken the 1960 figures put together by the Treasury for the late President Kennedy's February 6, 1961, message to the Congress on the U.S. balance of payments and the gold outflow and then made some guesses as to the 1964 figures that fit into these same categories of net payments and net receipts.

The figures are recorded in the table which follows. No official figures are aavilable as yet for 1964 as a whole, but guesses can be made on the basis of (i) full data for the first three quarters of the year, which are already available; (ii) selected data for the fourth quarter, which were released recently; and (iii) what we know of the seasonal and other factors that have affected the behavior of the principal items on which fourth-quarter information is not yet available.

How the main items in the U.S. balance of payments affected the deficit in 1960 and in 1964

[In billions of dollars]

	1960	1964
Overall deficit	3.8	3.0
Trade (exclusive of Government programs)	2.2	3.6
Income from private investment	2.2	3.5
Other items	1.7	2.4
Net receipts and deficit	9.9	12.5
Military expenditures abroad	3.0	2.8
Short-term capital	2.3	2.5
Long-term capital	2.1	4.0
Travel	1.0	1.7
Remittances and pensions	.8	.8
Economic aid	.7	.7
Net payments	9.9	12.5

NOTE.—The categories in the table and the 1960 data are from President Kennedy's Feb. 16, 1961, message to the Congress on the balance of payments; the 1964 data are estimates by Professor Saulnier.

What I can offer are guesses only, but they will be corrected or confirmed before long by official estimates and I doubt that they will be far out of the way.

What does this comparison of 1964 with 1960 tell us? It tells us that even when we look at annual figures we see very little progress in reducing the overall deficit; and the committee knows that my figure for the overall 1964 deficit is very much below the deficit, on an annual rate basis, that was incurred in the final quarter of the year.

It is perfectly clear that in our international balance of payments the drift of things is not good. We are not "approaching external balance."

To get then at the roots of the problem, we have to look at the various major items affecting the deficit. I direct your attention, first, to the two Government programs, military expenditures abroad and economic aid. It will be obvious that both appear in this table on a very net basis; what is shown is the net dollar outflow which arises from these programs, but not by any means the total amount spent abroad on them and by no means their total budgetary cost.

What the table does show is that in 4 years the net dollar outflow from military expenditures abroad has been reduced by only $200 million and that the net dollar outflow from foreign economic aid is unchanged.

I hasten to add that these results do far less than justice to the efforts that the agencies administering these programs have made to reduce net dollar outflows. In a very real sense, much progress has been made in these efforts. The trouble is that the progress has been largely or entirely overcome by other factors affecting the programs.

In the case of military programs, measures taken to check dollar outflow have been almost entirely offset by rising, what I call here, on-site costs. About one-half of our foreign military expenditures are in Western Europe and prices and wages have risen sharply there in recent years.

Price indexes show increases of 5 to 20 percent, depending on the country we have in mind and whether we are talking about consumer or wholesale prices; and labor costs indexes have risen in some cases by as much as 40 percent.

With the size of our military programs broadly unchanged, these on-site cost and price increases have pretty effectively canceled out what progress could be made—and it has been substantial—in supplying our forces from domestic production.

One naturally has southeast Asia in mind in thinking about these things, but it seems clear that offshore procurement has been reduced to the point where any further progress in reducing the net dollar outflow from military expenditures abroad must come, if it is to come at all, by reducing the dimensions of our military presence in Western Europe. I am no military expert, but it seems very strange to me that, considering what has happended in recent years in methods of defense, we need to have as large a military presence in Western Europe—especially as large a number of personnel—as we now have there.

It seems to me that the time has come to restudy the deployment of our military forces abroad; and I need not add that if things take a further turn for the worse in southeast Asia, the need for such a reappraisal will be greatly heightened.

In the case of economic aid programs, the table shows that no reduction at all has been made since 1960 in reducing net dollar outflow. Again, I must add that this veils entirely the efforts that the agencies administering these programs have made to check dollar outflows, and veils the accomplishment which should be credited to them.

It is, in fact, a major accomplishment that the net dollar outflow has been held unchanged when the total outpayments of dollars under the aid program have risen from $3.4 billion in 1960 to what I would guess was $4.5 billion in 1964. We know that the figure was $4.5 billion in 1963 and I judge it was roughly the same in 1964.

Net dollar outflow has been reduced from about 20 percent of foreign aid payments in 1960 to about 15 percent in 1964, but this progress has been offset by increasese in the dollar size of the program.

We must approach any revision of foreign economic aid programs, like changes in the deployment of military forces, with the most conscientious regard for the national policy considerations involved. But as a technical matter, it would appear that, since it will probably not be possible to reduce the net dollar outflow ratio much below the 15 percent level already reached, any balance-of-payments relief to be obtained in the foreign economic aid area can be obtained only by reducing the overall size of the program.

The typical sequence in public dialog on the balance-of-payments problem is first to acknowledge the net dollar outflows associated with foreign military expenditures and economic aid; second to express despair over doing anything to reduce them; and then to turn to private capital outflows as the place to find the required solutions.

It is in this last step that we are making our big mistake. Let me explain.

The point that is vital and crucial about private capital outflows is that they are a plus, not a minus, in our balance of international payments. The categories that were used in the 1961 presentation on the balance of payments—the categories used by President Kennedy—

and which I have tried to bring up to date in the table appended to this testimony, show clearly enough that private capital transactions have a dual effect in the balance of payments. There are inflows as well as outflows, and the inflows are actually very much larger than would appear from the table.

In the first place, the table gives $3.5 billion as income from private investment abroad in 1964, but this is a very "net" figure. We can estimate income from foreign private investment in 1964 at $4.8 billion, of which $3.7 billion was derived from direct investments abroad and $1.1 billion from portfolio investments. It is only when we net against this $4.8 billion figure an estimated $1.3 billion of payments to foreigners for their investments in the United States that we obtain the $3.5 billion noted in the table.

In the second place, a substantial amount of our exports arise from investments which American companies have made abroad. This question was dealt with in the study entitled "The U.S. Balance of Payments in 1968" which was published by the Brookings Institution in 1963.

In table V-8 of that study are estimates to the effect that direct investments abroad (1) induce exports from the United States equal to 10.6 percent annually of the amount of such investments outstanding; and (2) induce imports to the United States to the amount of 6.5 percent annually of our direct foreign investments. Thus, we have a net inducement of exports from the United States of 4.1 percent of the amount of our direct investments abroad.

The study stated that the value of these investments in 1961 was $34.7 billion and estimated that they would reach $50.1 billion in 1968. If we interpolate a value of $45 billion for 1964, which seems reasonable, the net induced trade effect for 1964 of U.S. private direct investment abroad may be placed at plus $1.8 billion. Together with the plus $4.8 billion of private foreign investment income, this demonstrates what I stated at the outset: Private capital accounts are a plus, not a minus, in the U.S. balance of international payments, and it is especially notable that they were a plus even under the swollen capital outflow conditions of 1964.

Now, because private foreign investment is a plus in our balance of payments, it follows that to take measures to reduce these investments is like killing the goose that lays the golden egg, and the simile is remarkably suitable. At least they will gravely impair one such goose.

No one will deny that, other things equal, we can help the balance of payments today if we reduce new private foreign investment outflows today. But we have to think about tomorrow, too.

The point is that a reduction of private capital outflows today will reduce our dollar inflows tomorrow. It can provide only a temporary assist. How temporary it is in the case of direct foreign investment may be seen from estimates made in the Brookings Institution study referred to earlier. This study estimated that, on a cumulative basis, the dollar outflow initially entailed in new direct foreign investment is fully offset in 5 years by the dollar inflow which it produces, that it becomes a plus in the 6th year, and that by the 10th year it has produced inflows more than twice the amount of the initial outflow.

The authors put it this way:

> By the end of the 10th year the sum of the inflows is more than double the original outflow and the beneficial effects continue at a growing rate thereafter.

Thus, as relief measures, attempts to correct a balance-of-payments disequilibrium by reducing private foreign investment are worse than merely temporary; after an interval—and in the case of direct foreign investment the interval is a short one—they are deficit inducing. They have, in short, a boomerang effect. Obviously, unless lasting correctives are found before the boomerang has had time to make its circuit, one can receive a very nasty blow.

I do not mean to deprecate the necessity for taking temporary relief measures such as those that have recently been announced. But we want to be sure that in achieving some success through temporary relief measures, we are not blinded to the necessity for finding basic correctives. The importance of such correctives cannot be overestimated. As things stand, it is just such activities as private foreign investment that make it possible for us to live with the minuses in our balance of payments: tourist expenditures, military expenditures abroad, and foreign economic aid.

The plain fact is that if we do not increase the plus factors in our balance of payments, we will be faced with the necessity of retrenchment in some one or more of these areas. I want to deal with the question of how we can avoid this necessity, but before I do that, I should like to comment on gold and on foreign short-term credits.

Balance-of-payments deficits are sometimes discussed as if we can be spared the necessity of finding basic remedies for them by giving up gold or by obtaining larger amounts of short-term credit from other nations. Other proposals have to do with the value of the dollar, internationally, involving either devaluation to a lower, but still fixed, parity, or the adoption of a fluctuating rate.

With a bearing on all these proposals, the Congress has recently enacted a law, under urgent pressure of events, which will make it possible for us legally to divest ourselves of increasing amounts of the gold we have left. I recognize the necessity of our having had to do this. It was a case of either changing the law or breaking it. But that does not dispose of the problem.

Gold is not an inexhaustible resource and neither is credit. Further, the Economic Report and other recent official statements have said that we will not have recourse to a change in the price of gold in order to "solve" our problem, and for this I am grateful. Indeed, the Treasury spoke of the "immutable price of $35," reaching into the thesaurus for what is perhaps the least ambiguous word in our language.

But if we are not to find ourselves at some future date in the position of having to take this word back, we must find some other solution for our balance-of-payments deficit than the export of gold or the search for additional short-term credits from the rest of the world. For one thing, we have to regard the domestic purchasing power of the dollar as having the same quality of immutability as we are properly striving to maintain for the dollar's external value.

Another aspect of the recently enacted gold legislation is that it means that day-to-day exercise of personal discretion, in this case by officials of the Federal Reserve System, is more than ever our protection against inflationary money supply increases. It is crucial in this case that those who exercise discretion be personally committed to the maintenance of the dollar's domestic purchasing power. The enactment of the gold cover law also reinforces my longstanding reservation

concerning any change in the organization of the Federal Reserve System that would reduce its independence.

Let me turn next to the instruments of policy which must be used if we are to find lasting correctives to the imbalance in our international payments. First and foremost is monetary policy. In the present case, a tightening of money policy is called for. This means a slowing of the present rapid rate of credit expansion, and it means a move toward higher interest rates, including higher long-term rates. If monetary policy is to be fully effective in helping our balance-of-payments solution, it must narrow the gap between the relatively low borrowing costs in our economy and the relatively higher interest rates elsewhere.

As a corrective instrument for use on a balance-of-payments problem, monetary policy has many advantages. First, it is positive as well as negative in its effects. Unlike the interest equalization tax, which is exclusively negative and prohibitive, a narrowing of the gap between the level of borrowing costs and investment yields here and abroad attracts funds into our economy at the same time that it tends to lessen the flow of domestic savings abroad.

Second, by using monetary policy, we keep international markets open instead of closing them with controls, as is typically done when monetary policy is immobilized. In this respect, the use of money policy is consistent with the best traditions of international behavior.

Third, it does its work impersonally and with wide coverage, obviating the whole apparatus of regulation and control which is otherwise necessary.

Fourth, in its domestic impact it denies any encouragement to the pressures that raise costs and prices and which, if allowed to work unchecked under conditions such as currently prevail in the American economy, are all too likely to take effect and weaken our competitive capabilities in world export markets.

Finally, by being willing to use monetary policy flexibly—as our friends abroad are, in fact, currently urging us to do—we give signals to the rest of the world that we mean what we say when we call the price of gold immutable. If we are not willing to do this, we may someday find ourselves going to the thesaurus and coming back empty-handed.

Yet we seem somehow fearful of using monetary policy lest it slow our growth rate and prevent us from eliminating the residual unemployment in our economy.

As to the first of these objections, I cannot resist the temptation to observe that it is a little odd that this point should be made when the Economic Report abounds in almost lyrical references to the recent growth performance of the American economy. I agree that the economy has been advancing at a fast clip. Considering the mixture of fiscal and monetary policy we have had, it would be a miracle, or a tragedy, if this were not the case.

But what the present pace of the economy signifies to me is that, if there ever was a time when monetary policy should be used actively, it is now. Two months ago I had occasion to say that, although I did not think the economy was then overheated, I thought it was as close to overheating as it was safe to get. Without a doubt, it is closer today than it was then. The time is here, if not a bit past, to take positive steps against overheating.

Without burdening the committee with a long recital of statistics, let me note, first, that the average length of the manufacturing work-week in January was 41.4 hours, the highest it has been since World War II. Second, credit has been expanding of late at what is, for this season of the year, an exceptionally rapid rate.

These facts justify concern on two grounds. First, when an economy is operating at such a high pitch of activity, rapid credit expansion is almost certain to generate cost and price increases that will worsen any existing balance-of-payments deficit. This is the international ground for concern.

Second, it is very unlikely that a rate of expansion such as we are presently experiencing can be sustained for any appreciable period of time. This is the domestic ground for concern.

On this latter point, it is the teaching of experience that the seeds of economic recession are to be found in the excesses that develop during periods of expansion. If we go too slow at times, it is usually because we have gone too fast just previously. If we moderate our speed a bit right now, using monetary policy to that end, we will have a better chance of extending the expansion without interruption.

The fact that the expansion has been in course for 4 years does not, in itself, mean that it must end soon. Let me make myself quite clear on this point. There is no necessary reason why the expansion should not go on indefinitely, and the secret to keeping it going indefinitely is a simple one: It is to avoid surges and spurts.

There is a lot for us to learn on this point from recent Western European experience. It was only 2 years ago that many observers were saying that Western Europe had learned to achieve fast economic growth by liberal monetary and fiscal policies and that all we had to do was to follow their example. But today every country in Western Europe, not excepting West Germany, is struggling against some degree of cost and price inflation and in some cases against very substantial degrees. In the process, several of them are registering no growth at all and one—I have reference to Italy, Mr. Chairman—has actually experienced recession.

All the same, I expect Western Europe to come out of its difficulties this year in reasonably good shape, and I should say, Mr. Chairman, I make a particular point of keeping myself informed on how things are going in Western Europe, but only because every country there has been willing to use monetary policy, and fiscal policy, too, to suppress inflationary tendencies, and it is noteworthy that they are sufficiently persuaded of the correctness of their policies to be advising the United States not to be overly shy about using monetary and fiscal policy to help remedy its payments imbalance.

I don't like higher interest rates any more than I like higher prices of anything else, and I am not saying we should move blindly to a higher level of interest rates. What I am saying is that this is the time to move, but, of course, we should move cautiously. We can perhaps afford to lean on our improvisations and temporary relief measures in the process; but we should move, all the same.

To make such policy moves does not mean that we sacrifice all chances of eliminating residual unemployment. We all want to reach the 4-percent unemployment ratio, and to keep on moving to lower ratios. The question is not one of objectives; the question is how to achieve them.

I believe we are at a point where the help we can get in reducing residual unemployment from further artificially induced increases in aggregate demand will entail too high a price in terms of harmful side effects. Demand must remain high and it must grow, as it will, but our approach to the residual unemployment problem should through selective programs of job training, job counseling, and placement.

I congratulate the Council of Economic Advisers for the support it gives nowadays to the structuralist approach to the elimination of residual unemployment.

I should add, Mr. Chairman, that I want also to express the gratitude of all of us for the work that this committee has done in its studies of the unemployment problem and its careful and extensive studies of ways and means of correcting that and in particular what it has done, and that is a very great accomplishment, what the committee has done to specify in great detail the character of the selective programs of training, of counseling, and placement which in my judgment are crucial to success in this connection.

Fiscal policy is the second major instrument which can be used to help bring international payments closer to balance. Fortunately, President Johnson put forward a budget for the fiscal year 1965 which moderated the rate of increase of Federal cash payments to the public. Indeed, it was principally this that made it possible to have the 1964 tax cut without harmful side effects.

The analysis in the Economic Report of the tax cut's effect gives little or no weight to this factor, but it should be clear that, if the tax cut had been enacted jointly with a large expenditure increase, we might very well be talking today about a plain case of inflation in the American economy. Credit that we are not talking about that goes to those who counseled expenditure control in 1964 and those who put it into effect.

But what about the fiscal 1966 budget? I have been surprised at the extent to which this is being regarded as a kind of austerity budget. Actually, it is a very expansionist budget. If the President's proposals are enacted, Federal cash payments to the public will be $6 billion higher in fiscal 1966 than in the current fiscal year and I should like at this point to interpolate, Mr. Chairman, that if we take account of the effect in budgetary statements of the proposed increase in the sale of federally held financial assets, the increase in the level of Federal cash payments to the public would be approximately $6.9 billion rather than $6 billion, as stated in my written testimony.

Presumably the increase will start in July of this year. How fast the pace will be, one cannot tell. The big expenditure increase will come, not in the purchase of military hardware, which is where it came in large part between 1961 and 1964, but in transfer payments to individuals and in Federal grants-in-aid to States and local governments.

In general, the funds will go for various programs in the areas of health, education, and welfare. I have no general criticism of the type of expenditure increases contemplated, though we want to be sure we don't undersupport our Defense Establishment. If I may, Mr. Chairman, I would like to emphasize that point. My major concern is with the volume of expenditures relative to prospective receipts. Jointly with the contemplated reduction in excise taxes, the

big increase that is projected in spending will produce a $5.3 billion deficit in the administrative budget in fiscal 1966. This is $1 billion less than the $6.3 billion deficit that is now officially projected for fiscal 1965.

But it is a different story when we look at the cash consolidated statement. When the fiscal 1965 budget was first sent to the Congress, it was estimated that the cash deficit would be $2.9 billion; in October this was lifted to $3.5 billion and in the January 1965 budget message it was lifted once more, this time to $4 billion.

The budget message tells us that the cash deficit in fiscal 1966 will be $3.9 billion, that is, it will be reduced hardly at all.

Furthermore, we must consider the fact that sales of federally held financial assets are expected to be nearly $900 million greater in fiscal 1966 than in fiscal 1965. This means that, in economic and financial effect, the difference between the cash deficits of the 2 years is not that the fiscal 1966 deficit is $100 million below the deficit for fiscal 1965, but that it is $800 million larger.

Any reluctance there may be to use monetary policy more vigorously on the ground that fiscal policy is turning restrictionist can be put aside. The danger is that the mix of policy will be too rich on the fiscal side.

One more point of fiscal policy. One way to keep investment funds home and to attract foreign investment funds here—and thus to help correct our payments imbalance—would be to make an additional cut in the corporate income tax. And I mean a cut at some fairly early date, in addition to what is already contemplated. It will be helpful at some time to get excise taxes removed from the Federal tax system, as is currently proposed, but a reduction of the corporate income tax would be more beneficial as far as the balance of payments is concerned. And while its first effect would be to increase investment return, its later effect, as it was passed on to the consumer, would be to expand demand in domestic markets. The impact sequence could not be more appropriate in our present situation. I hope this committee will do all it can to see that our war-inflated corporate income tax is reduced, step by step, as rapidly as is consistent with the stability of the economy and with fiscal prudence.

Finally, the most important thing for us to do, and I repeat those words, Mr. Chairman, the most important thing for us to do, if we are really to correct our payments imbalance is to improve our export capability and produce a surplus on trade account very much larger than the substantial surplus we now have.

We began efforts in this direction in 1958 and they were continued vigorously under Secretary Hodges. We should all be grateful for the energy and dedication which he applied to that task. But we have to do more. Since 1960 our exports have grown only in about proportion to our gross national product and have actually increased less than world exports as a whole.

In other words, our penetration of world markets, considered as a whole, is actually less today than it was in 1960. This is where the big push of policy should come. Partly, it is a matter of getting our businesses interested in exports and interested in designing products that will be attractive to foreign purchases. And I should like to interpolate, Mr. Chairman, that although we have been, I think it is fair

to say, remarkably successful in reaching into world export markets for the sale of machinery and industrial equipment, it is interesting that we have been really quite notoriously unsuccessful when it comes to reaching world export markets for the things that are, Mr. Chairman, the pride and joy of our American standard of living; namely, consumer durable goods, not excluding the automobile.

And it is not, Mr. Chairman, it seems to me, a convincing or persuasive point for one to say that our automobiles are too big for the roads of Western Europe. They are too big for the roads of Western Europe, but that is no reason why we should not be designing automobiles to fit the roads of Western Europe and why we should not be producing them here and shipping them from here to Western Europe.

The same applies, Mr. Chairman, for the whole long line of consumer household appliances which we regard so highly, and which are of such high quality, but which to all intents and purposes get shipped not at all to foreign markets.

Continuing with my testimony, Mr. Chairman, and I will be finished here in about 1 minute, partly it is a matter of building effective sales organizations abroad. But it is also a question of keeping our products priced at levels that will increase sales abroad. This is where the wage and productivity relation comes into the problem.

To enhance our competitiveness abroad, wage increases must be well within the rate of productivity advances, and I mean "well within." We have had a good record in this respect in the past few years, which in my judgment is the principal reason why we have had so favorable an economic performance.

In view of the present high pitch of economic activity and the high-cost settlements that have recently been made, this is an area that the Joint Economic Committee will want to watch with special care in 1965. Indeed, Mr. Chairman, I would recommend that notwithstanding the extensive and very useful studies that this committee has made in the past on this very question, that its attention be directly focused at this time to ways and means of continuing as good a performance with respect to the relationship between wage increases and productivity improvements as we have had in recent years.

In that connection, Mr. Chairman, I know that the committee will be seeking especially, I would hope exclusively, for ways and means of doing this that are consistent with minimum governmental intervention in labor markets and with the maintenance, to the fullest extent possible, of free collective bargaining.

This is the time to concentrate on essentials. I shall close, therefore, by urging the Joint Economic Committee to focus its attention in its report this year to the Congress on the problem of our international balance of payments.

The international balance of payments is not always in the center of the stage and for that we can be thankful. Indeed it is rarely the centerpiece in American dialog on economic policy. But it is today, and it is for that reason, sir, in urging that we concentrate on essentials, that I recommend the committee to make a particular point of orienting its report to the Congress toward the question of reaching lasting solutions to our international balance-of-payments problem.

The committee would render a most important service if it were to put forward a program, going beyond what has already been requested by the administration, that will provide lasting correctives for the imbalance that exists and obviate the need for the temporary relief measures on which we are now relying.

The program should concentrate on building up the pluses in our balance of payments, in order that we can be spared the need to retrench on the minuses. I need not remind the committee that at least two of the minuses—our programs of economic aid and our essential miltary defense programs—are heavy with national interest.

Mr. SAULNIER. Thank you very much, Mr. Chairman and members of the commiteee.

Chairman PATMAN. Thank you, sir. I want to ask you one question. That is on the question of gold. I want you to comment if you will, please, sir, on the fact that our country is the only one that pays on demand to central banks.

Other countries do not. And France seems to be entering upon a policy of causing us as much embarrassment as is possible to cause—I don't say that it will succeed—by demanding gold under circumstances that certainly appear to be at least unfair. Moreover, they are not very appreciative of what we have done for France in the past. Considering, too, that we have military expenditures of about $200 to $300 million in France every year, what do you think we should do about the situation?

Will you comment on those questions, please?

Mr. SAULNIER. Yes, I will be glad to comment on them, Mr. Chairman.

I had occasion only a week ago to write a short piece for Les Echos, a French financial daily, which contains some comment on conditions in France—a contribution made at their invitation, sir—and also some comment on President de Gaulle's interesting observations on gold.

It might be interesting to the committee if I were to supply you with a copy of that piece and I will be glad to do so.

Chairman PATMAN. Without objection, it will be placed in the record.

(The article referred to follows:)

REFLECTIONS ON THE FRENCH ECONOMY AND ON PRESIDENT DE GAULLE'S PROPOSALS REGARDING GOLD

Because I have only just finished reading newspaper accounts of President de Gaulle's February 4 press conference, it is impossible for me to write these comments without referring to his interesting proposals on the subject of gold.

The gold standard, as we all know, is essentially a discipline, a kind of built-in and semiautomatic stabilizing device. When one considers the extent to which costs and prices have recently been rising in France, and in Western Europe generally, one is impressed by the need for some device of this kind. And while we economists would be distressed to see automation carried too far in this connection, I would say that the more automatic the stabilizing device and the less it depends on personal direction, the better for all concerned. The interesting question is whether the general's proposals regarding gold will provide us with such a mechanism. To judge this question, consider what has happened in recent years in the major Western European economies. For this purpose, it is instructive to consider separately the period 1955 through 1960 and the years since 1960.

Up to and including 1960, it looked very much as if our Western European friends had discovered a formula for achieving rapid economic growth without inflation. I was in Government at the time, and I was constantly being re-

minded (not always good naturedly) of the failings of the U.S. economy and of Western Europe's successes. Basically, the secret of your success was that, on the average, your unit costs of production remained relatively stable. And they were stable because your wage increases were well within the limits of your productivity improvements. In our economy, the shoe was on the other foot, and it was pinching.

Since 1960, however, things have been very different. In these years you seem to have contracted a rather serious case of what I was beginning to think was strictly an American disease; namely, a tendency toward inflation. In the first place, you have had a very rapid expansion of credit. You have had large governmental budgetary deficits, financed in part by recourse to your central bank. You have had a rapid expansion of credit to business concerns. You have had a building boom, and no one can have a building boom without having a mortgage credit expansion. And, finally, you have made increasing use of consumer installment credit. The last mentioned is something in which Americans feel (uneasily, to be sure) a certain pride of discovery. We are happy to share this remarkable tonic with you but you will be well advised to use it in moderate doses. It is not surprising, of course, that this expansion of credit has been accompanied by an expansion of your money supply. In the period 1960–63, the increase averaged 15 percent a year.

Now, a credit and monetary expansion on this scale is invitation enough to inflation, especially when an economy is at or approaching full employment, but after 1960 France and her Western European neighbors introduced a second inflation-producing force into their economies; namely, wage increases substantially in excess of productivity improvements. I'm afraid no one really knows how fast productivity was improving in France in 1960–63, but we do know, on the basis of OECD statistics, that manufacturing wage rates were rising by 9 percent a year. Productivity must have been improving at a much slower rate because wholesale prices rose annually by close to 3 percent.

It is to France's credit that steps were taken fairly promptly to bring this inflationary process under control. The program seems to have worked rather well in some respects, but it is not clear that the inflationary pressures have been entirely eliminated. Certainly you have succeeded in retarding the expansion of money and credit. But I fear you have been less successful in curbing increases in costs. Indeed, in the last 12 months for which data are available, wage rates in manufacturing went up by another 8 percent and wholesale prices by 3 percent. It would have been much better if wage increases had been less than 5 percent a year, on the average. This would have permitted you to enjoy the best of all possible economic worlds: a high and rising level of production, with stable prices.

This brings me back to gold and to President de Gaulle's proposals. As I have said, the gold standard is a discipline. Certainly it imposes a discipline over the expansion of money and credit and thus overdemand inflation. And in this connection its impact is fairly immediate and direct. Its impact on cost inflation, however, is less direct. Here it works entirely through unemployment. I do not say this to disparage the gold standard because, as a liberal in what I regard as the true sense of that word, I admire such arrangements. But we must recognize that if we choose this road we shall find that it is not always a smooth one.

And I am troubled by a second point. It seems to me that in the last few years a full gold standard system would have worked rather awkwardly. In the first place, it would have had a severely deflationary effect on the United States. This might have been a good thing in some respects, but it would have been far from an unmixed blessing. And I say this thinking of the interests of other countries as well as of the United States. Furthermore, our cost and price performance in this period has been better than the French performance, if I may say so. Second, in Italy a gold standard would have put the brakes on sharply and early. This might have been a good thing. It is an open question, but conceivably a gold standard might have worked more smoothly than the stabilization program that had to be improvised in the situation. Third, a gold standard would have been heavily deflationary on the British economy. Again, this might have been beneficial, but the performance of costs and prices in the British economy in recent years has been rather better than that of the French economy. At least this was true until 1964. If the gold standard had worked for Britain, it could have worked only by reducing that country's growth rate by a substantial margin. And I doubt that a slower growth rate, by itself, would have solved Britain's payments problem. Certainly it would have created some additional problems. Finally, it is interesting that despite the fact that France in the

past few years has come very close to leading the parade as regards cost inflation (a dubious distinction, I fear), a full gold standard would have exerted a further inflationary effect on its economy. In short, it is not clear that in our complex world the full gold standard would have provided the right medicine in the past few years or that its medicine would have been administered to the patients who needed it most.

Perhaps I am reading too much into President de Gaulle's suggestions when I picture a return to the full gold standard. Actually, he spoke also of "transitory" or "provisional" arrangements, by which I assume he meant that some modification of the present gold exchange standard might be adopted before moving to a full gold standard. This may be the road we take, though on that subject I write with no special knowledge or authority. But I doubt that we shall together undertake the full journey that the general has mapped out. Indeed, I expect we may find that the transitory arrangements are a good bit more attractive than the ultimate goal. In this connection it occurs to me that there is much truth in what I understand is an old French proverb to the effect that "* * * nothing lasts as long as the transitory."

Mr. SAULNIER. The first point that I would make about this is that while it is embarrassing at this time for anyone to raise questions with the United States concerning gold, this results only from the fact that we have had a very large balance-of-payments deficit for 6 years now, and that we are in a rather tight spot.

We are in a position, in other words, Mr. Chairman, to be embarrassed very easily.

Now the fact of the matter is that President de Gaulle, or I should say the French Government, was not really doing anything very unusual when they chose to take some gold. Indeed, unless I misunderstand the situation, and I don't think I do, Mr. Chairman, the French hold a somewhat lower percentage of their foreign exchange reserves in gold than do the other major industrial countries of Western Europe, with the exception of West Germany.

And what the French were doing in this case was simply bringing their gold percentage back to the point where, in their policy, they long ago decided it should be.

The case, Mr. Chairman, can be illustrated this way. Suppose you have a business concern that kept bank balances in a number of banks. Let us suppose that over a period of a year its total bank balances increased, and at the end of the year it looked at the distribution of those balances as among different banks and found that the distribution was different from what it had earlier decided it should be. The company might see a particular bank in which it had been its policy to hold, let us say, 75 percent of its deposits. Well, if they looked at the figures at the end of the year and found that that bank has only got, say, 60 percent of the deposits, because the additional deposits had gone to other banks, there could be a basis for shifting deposits.

Now at that point they have to ask themselves a policy question. Do we want to change our policy and hold only 60 percent of our deposits with this bank or do we want to hold 75 percent of our deposits there as originally decided? If there is some reason for changing the policy they will do so. If there is no good reason for changing the policy they will say we were right in the first place, 75 percent should be held in this bank, therefore, they ask the treasurer to shift some balances to get the percentages back to conform with their policy.

Now this is, I believe, Mr. Chairman, a perfectly correct analogy to what the French are doing at this time as regards gold.

Chairman PATMAN. I don't see where it is comparable to your illustration there; maybe I did not get it. But the corporation that

you dealt with had charge of these accounts in these different banks.

Mr. SAULNIER. Yes.

Chairman PATMAN. Now France does not have charge in all these different countries.

Mr. SAULNIER. It has dominion over its deposits, sir.

Chairman PATMAN. France is dealing with her own situation. She is not indignant because she can't get gold from other countries and she seems to be getting along fairly well with the Soviets and the Soviets have $200 million in gold they are trying to peddle right now.

They don't seem indignant that they can't get gold from other countries. I am wondering if we should continue to let France have gold under those circumstances.

Mr. SAULNIER. I must, Mr. Chairman, take exception to what is really the basic premise of your remarks; namely that France does not have dominion, so to speak, or control or authority over these balances. It does have control over its balances.

Chairman PATMAN. Balances in other countries. The corporation has control of its balance in each of the banks you mentioned but France does not have control of the other countries' balances in their countries.

Mr. SAULNIER. France has control of its balances.

Chairman PATMAN. Of its particular balances.

Mr. SAULNIER. Of its particuar balances, held in other countries.

Chairman PATMAN. That is true, particular balances, but not the other countries' balances.

Mr. SAULNIER. Oh, no, they do not have control over my balance, your balance, or anybody else's.

Chairman PATMAN. What do you suggest be done? Nothing? Or do you suggest that we do something to deal with this situation where gold goes to France at a time when they can't get it from any other country?

Mr. SAULNIER. I would suggest this, Mr. Chairman. Repeating what I said, that we are embarrassed by what the French did because we are in a very tight position with respect to gold. The basic suggestion that one should make at this time is a most vigorous push of policy, with every agency of the Federal Government participating, to correct that deficit in our balance of international payments.

Now in the interim, Mr. Chairman, we have to depend on improvisations and temporary relief measures. That I concede.

Chairman PATMAN. But if we correct these things France can still get gold from us if they have dollars.

Mr. SAULNIER. May I complete, Mr. Chairman, in a moment?

Chairman PATMAN. Yes, go ahead.

Mr. SAULNIER. We can give the gold to France. We have given the gold to France. They had a right to ask for it. It is, I think, a rather good thing in some ways that they asked for it because it has heightened interest in a problem which might otherwise have received inadequate attention.

Now, clearly, this is a time for us to sit down with our friends and our allies around the world and talk about the international currency reserve system. This is something that we have been doing, I know. We must continue to do it. When we do that, Mr. Chairman, I doubt very much that we are going to come out with President de Gaulle's solution. My guess is that we are going to reach a solution which is

intermediate between what we have now and what President de Gaulle is talking about.

You may recall, Mr. Chairman, that in his statement, his press statement, he spoke of the gold standard as the ultimate goal but spoke also of transitory and provisional arrangements which would build on the present gold exchange standards.

Chairman PATMAN. Thank you, sir. Mr. Curtis.

Representative CURTIS. Mr. Saulnier, I am very pleased that you have given the emphasis that you have to our balance of international payments problem.

First, I would make the observation that of course there are two ways of settling our yearly balance-of-payments deficits. One method of settlement is the payment of gold and the other is the payment of dollars. I think entirely too much time has been spent by this administration in boasting that we are able to cut down on the rate of flow of gold out of the country, while at the same time the deficits are continuing. For various reasons on our part, we have persuaded our creditors to take dollars and not to ask for gold. This is no real solution to the balance-of-payments problem and, in fact, is a time bomb.

Much of this has been purely temporizing, as you point out. I am pleased that you brought up the relation between our private investment and our exports and, of course, what we do get pluswise from the investment itself.

The administration's policy is to undermine this plus feature with the interest equalization tax and the other techniques.

The second plus is our trade surplus.

The third and probably the most important and the most difficult is the domestic climate for our own investment. This involves the problems of inflation and cost and monetary policy and debt policy. The minuses are Government capital investment abroad on the governmental sector, and Government expenditures abroad. The budget, as I interpret it, both in domestic and foreign policy, puts more emphasis on Government activity at the sacrifice of the marketplace decision where the pluses all have been occurring.

In other words, the damage stems from Government decisions which have proved to be poor, in restrospect while the President's Economic Report boasts about what the Government has done, I would like to make a distinction between decisions made through the political mechanism and those made in the private sector. Analyzing the report one finds that the boasting is actually about what the private sector has done.

Now I want to pose some questions to illustrate the points I have just made. The Alliance for Progress, was supposed to be a $20 billion capital investment program for 20 years, half of the funds to be provided by governmental sector and half by the private sector.

A request was recently made on the floor of the House for an additional $750 million for the Inter-American Development Bank to be provided by the governmental sector. The testimony of the administration was all along the lines of what we were doing in the governmental sector and nowhere in their testimony or in the Economic Report was any attention directed to what is happening to the $10 billion in the private sector.

This committee went into this to some degree, and we found that in 1 year there actually was a minus in the private sector. I suggest that

this is an example of Curtis' corollary to Gresham's law, which is that Government money drives out private money. I asked Secretary Dillon why it can be argued that private capital investment abroad is hurting the balance of payments, while it is also argued that the $750 million of Government investment abroad is not hurting the balance. I wonder if you can supply any answer as to what the difference is, as far as the balance of payments is concerned, as to whether investment is made by our governmental mechanism or whether it is made through the private sector?

Mr. SAULNIER. As a technical matter, there is no difference. A dollar of private capital outflow has the same immediate bookkeeping effect on the balance of payments as does a dollar of Government capital outflow and vice versa.

Of course, there is a good deal of difference in the sense that it affects the shape and impact of our capital export. I do not deprecate the importance of government programs looking to the building up of infrastructure in the developing countries, but I would prefer to see the capital flowing out as private capital, not as public capital. But I would have to say, Congressman Curtis, that the two have, in their initial impact, the same effect on the balance of payments.

Representative CURTIS. I thank the gentleman. I would like to state my own personal views. I think there is a place for governmental capital, but I think it is foolhardy to look at only one side of this coin, what Government is doing, while completely ignoring what is going on in the private sector.

This is what the budget message seems to do in both foreign policy as well as domestic. It is certainly true of the committee hearings and the committee report on the problem of the Inter-American Development Bank.

I hope this committee will look again at what has happened to private investment. I don't think the corollary has to go into effect. I do believe the investment policy can be well defined so as to stimulate private capital investment instead of replacing or driving it out.

But Curtis' corollary is certain to go into effect when we operated out of ignorance and then seek to cover up our ignorance by propaganda to the effect that we want to help people abroad.

We want to help people and the argument should be, first, how to best do this and then about the details. Now, your development of domestic policy. It has been my observation that today our monetary policies are so interwoven with debt management policy that the latter restricts the former. In addition, almost all our deficits since 1957 have been financed by marketable debt rather than in nonmarketable debt.

And today through the Federal Reserve System our debt management policies are inextricably woven with monetary policy to the point where I think we cannot move very freely in monetary policy.

Look how we handled the problem of trying to keep short-term interest rates high and long-term interest rates low. Essentially, we did it through marketing the Federal debt and putting it into bills rather than through the traditional operations of monetary policy.

Would you comment on this?

Mr. SAULNIER. You certainly are not in error in stating that these two operations are closely interconnected; namely, debt management and the whole apparatus of monetary policy. That is perfectly cor-

rect. But I would not acknowledge, myself, that the debt management problems which we face today are such that they immobilize monetary policy. In my judgment they do not.

Representative CURTIS. You think there is still the flexibility?

Mr. SAULNIER. Yes, indeed I do. I would like to say to you and to the other members of the committee that I do not want to imply by my testimony that I think there has been no move at all on the part of the Federal Reserve System.

I would judge that there has been some move in the direction that I have described as being desirable at this time.

Representative CURTIS. My time is up but I would like to ask why you don't feel that this flexibility has been impaired. My own judgment is that it has been seriously impaired and I think it is very important that we start examining the implications of the problems in debt management, particularly as they relate to our monetary policy.

Mr. SAULNIER. May I comment on that for just a moment, Mr. Chairman, to say or to recall that in 1952, when our debt management policy had pegged the long-term interest rate at 2½ percent, that it was said then, too, that debt management problems had immobilized money policy.

And believing that it had immobilized monetary policy, what Government did was to erect a whole apparatus of selective credit controls to do the kind of thing that a flexible money policy would have done had we used it.

Representative CURTIS. Could we have used it?

Mr. SAULNIER. We had those controls. Then suddenly an accord was announced and we were back into a world of flexible money policy. We did not move very quickly into it. Steps were taken to ease the readjustment of money market, of rates and bond yields.

And we eventually found ourselves back at an interest rate level not much different from the level at which we find ourselves now. I would say this was the case of rediscovering flexible monetary policy, in the face of warnings that debt management made that impossible. But the warnings proved to have been incorrect. We did make the adjustment and I think, broadly speaking, to the satisfaction of most people.

Chairman PATMAN. Thank you, sir. If you desire to enlarge upon that you may extend your remarks when you look over your transcript. Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman.

I want to join in welcoming you, Dr. Saulnier. You always add to our deliberations, and particularly this morning I am glad you chose as your major field of analysis the balance of payments: one, because it is vitally important; and two, because maybe we of the committee have been a little light on that topic so far.

I would like to address myself to one of your principal contentions which you make again on page 7 of your report when you say, "Private capital accounts are a plus, not a minus, in the U.S. balance of international payments."

You reach that conclusion by pointing out, first, that when an American industry builds a plant overseas, it gets, sometimes repatriates income over the years.

Mr. SAULNIER. Normally it does.

Representative REUSS. Which, of course, is a benefit in our balance of payments. It may be easier to understand if we put this in concrete terms. One of our good Wisconsin companies, Outboard Marine, like other American companies, a couple of years ago built a plant in Belgium which now makes the 3-horsepower outboard motor that fishermen and hunters used exclusively.

As that plant makes money and repatriates it, then you went on to show that when that plant or a plant like it was being built, and thereafter some of the—and then some of the components are made in the United States, so that adds to our exports and that is good.

Then you took into account that sometimes these plants induce new exports from the United States and imports to us and you properly subtract it when we buy a 3-horsepower Outboard Marine motor that used to be made in the United States and is now made in Belgium that that is a proper offset.

However, did you take into account an important element; namely, the fact that when we establish a plant abroad, like Outboard Marine, again, just to stick to the example, that displaces American exports which used to be made to Belgium where that plant is located and indeed used to be made to the whole rest of the world?

In this particular case, and it is quite typical, we don't make 3-horsepower motors anymore in Milwaukee. They are made in Belgium, and those we used to sell to Belgium, to Algeria, to India, all over the world, are now made there.

Do you have an offset item for that in your calculations here?

Mr. SAULNIER. I have no doubt something of that sort does occur. The offset item is that that plant set up abroad may produce some things there which will come back to this country, be imports for us. Does that cover the case you have in mind?

Representative REUSS. No; I am talking about the displacement of our exports abroad. That is to say, when Outboard Marine or any other American company, established this plant in Belgium, we thereby lost export sales which used, which related to outboard motors that used to be made in Milwaukee and were shipped to Belgium and everywhere else in the world, but now are not so made and so shipped, because they are made in Belgium and are either sold in Belgium or anywhere else in the world.

Mr. SAULNIER. I think there could be some effect of that kind. To the best of my knowledge that was not taken account of in the particular calculations of the Brookings Institution study to which I was referring. I would be glad to check that point and comment on it for the committee's information, if you wish me to do so.

May I say this, Congressman Reuss. The fact is that our export trade is, overall, a large plus, as it stands. It might conceivably be a larger plus if investments such as those to which you refer did not occur, but in that case we would have to cancel out against them the full amount of the pluses I have described. I doubt very much that the minus of which you are speaking would overcome the pluses I have described.

Now just one further comment, Congressman Reuss, I want to concede that this kind of effect could be felt. What do we do about it? What we can do about it is to improve our own domestic capability for making those things that can be sold to the rest of the world and thus obviate the need for a company, which might otherwise be pro-

ducing here, going abroad to produce for foreign markets over there.

And I would say, Congressman Reuss, that the more I have reflected over this problem the more I am persuaded that the best way, the most effective way, to solve it is to increase our exports, and that means to keep our own costs and prices here in the United States under control and to do a better job of designing things that will be attractive to foreigners.

Representative REUSS. I would agree with that. I was just trying to get into the arithmetic of your statement that private capital accounts are a plus not a minus.

In this connection I call your attention to the Brookings 1963 report which was the basis of your statement, particularly to table V–8 on page 144, and to the last paragraph on page 146 where it says, and I quote:

> * * * nothing was counted for the loss of exports displaced by sales from foreign facilities, an element weakening the balance of payments. There is no way to make an educated guess as to the possible magnitude of this effect, although certain facts can be brought out. The total value of sales of European manufacturing subsidiaries averaged around $8 billion per year for the years 1957 to 1960 and was in excess of $10 billion in 1961. If even a small fraction of these sales replaced American exports, they adversely affected the balance of payments by a considerable amount.

I am not going to make an educated guess here either, but it does seem to me that some important offset to this has to be made.

Mr. SAULNIER. I think there is some offset. How important it is, I don't know. As they have said themselves, and they have studied this as closely, if not more closely, than anyone else I know, that they have not been able to make an educated guess on it.

I would say, Congressman Reuss, from our point of view what it tells us is that the long-term and lasting remedies here are to improve our capability to compete in foreign markets.

Representative REUSS. Let me hastily pass over, while expressing my complete agreement with you, in your thought that our military payments in Western Europe could be the source of considerable saving in our current balance-of-payments deficit without in anyway weakening our fundamental military posture.

Mr. SAULNIER. I am inclined to agree or, I should say, I am inclined to believe that, myself. But I always hesitate to express judgments on these questions because they are really quite outside my field of competence.

Representative REUSS. Unfortunately, my time is up.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Mr. Chairman, I am very grateful to the Chair and to my colleagues for allowing me to take 5 minutes out of turn. I will make it half the time so as not to intrude.

Mr. Saulnier, first thank you very much for being here to express a point of view which the minority wanted very much to see expressed in so expert and informed way as only you can do it. We are very grateful to you, and I think it is a real service to the Nation that you are performing today. I just have a question.

First, I could not agree with you more as to picking the balance of payments as the key to American financial health and prosperity at this current time.

Second, I notice three prescriptions which you make. One, in your your statement you say—

Demand must remain high and it must grow, as it will, but our approach to the residual unemployment problem should be through selected programs of job training, job counseling, and placement.

Now would you favor a material increase in those programs if it could be administratively handled on the theory that you have got to do something, and if we are going to put a concentration on this, then we really have to be honest about it and give it a material shove forward.

Mr. SAULNIER. I would agree with that entirely, Senator Javits. I have been, as you may know, arguing the case of the structuralists for some years, and especially the last few years. I would like to emphasize, Senator, that when you look at the unemployment figures, we are not doing too badly as far as the experienced male, white worker is concerned. But we are not doing well at all as far as the young, nonwhite potential worker is concerned.

Senator JAVITS. Where rates of unemployment are two, three, and four times the overall average.

Mr. SAULNIER. Rates of unemployment are 20 percent or higher and especially among nonwhite, female members of the labor force.

Senator JAVITS. So to pinpoint it, you would rather see us spend money in this area for all purposes, training, travel, if necessary, relocation, maintenance payments, which we do in some cases, rather than approach this thing through the public works route?

Mr. SAULNIER. The only limitation I would place on expenditures in this area, Senator Javits, is the ability to spend the money constructively.

Senator JAVITS. Thank you very much, because that is most important.

Now the second point. On page 16 you deal with the export trade there and the need for a major increase in our export surplus.

Now would an additional way to get an increase in our export surplus be through an improvement of our export financing system, perhaps by extending credit for longer terms, and to accompany them with large amounts of technical assistance in underdeveloped areas which may not be able to pay on present terms?

In short, should we be more creative in the effort to help the underdeveloped areas, which are the biggest potential export markets, even though it may take longer term credit? Would you approve, again within the limits of administrative feasibility, and so forth, of greater Government assistance to bring that about?

Mr. SAULNIER. Well, I would want to study the figures very closely, Senator Javits, because when we ship goods abroad under credit, we are in effect working on both sides of the balance of international payments. We have a minus credit item and a plus goods export item. But I certainly would not want to foreclose any possibility that there may be some constructive things that can be done along these lines.

Senator JAVITS. I notice also your recommendations that we be more realistic about interest rates and the possibility of an additional cut in our corporate income tax to attract investments to the United States.

Again, I approve very much of those propositions as feasible alternatives. I may not necessarily be for them, but I think it is very important that we understand, and that is your purpose here, that there are other things we can do. I gather that is the spirit in which you put them forth.

Mr. SAULNIER. That is the spirit in which I am making these proposals. I should like to say that I have been gratified at the readiness of the Congress to take steps, as it did in 1964, to make substantial cuts in the corporate income tax, to make revisions in our handling of depreciation allowances, and to do other things that have tended to stimulate the investment of funds in our own economy. I think we can all be gratified, too, that these steps have proved to be very helpful.

Senator JAVITS. Now my last question concerns the problems of economic aid. I noticed what you said about military matters such as the possibility of retrenchment in an absolute sense without the sacrifice of security, and whether or not it is the symbolic American presence in Western Europe, which is the cement which holds NATO together, and whether that symbolic American presence cannot be just as much assured with three divisions as with five or with four as with five or whatever the quantum might be that is less than five, and I think they deserve our utmost consideration.

I would like to ask you one question on economic aid. Assuming that people like myself believe that the level of economic aid is even now inadequate, do you feel that there is an enormous residual potential we have not yet developed in the private enterprise and private investment field and, therefore, would you favor Government encouragement by tax means as well as by guaranty means of the effort to have the private enterprise system more fully fill in the gap which you feel we ought to be retrenching on to some extent in the foreign economic aid field?

Mr. SAULNIER. I would give every support I could muster to measures of that type.

Senator JAVITS. May I finally say that I consider your observations on the validity of American investment abroad both in terms of national security, national power, and business as very astute and I agree with them thoroughly.

Thank you, Mr. Chairman.

Representative REUSS (presiding). Senator Proxmire.

Senator PROXMIRE. I wish Senator Javits had been here to ask that last question of Professor Galbraith. I asked something similar to that, saying I was afraid we might retard our foreign investments and that would be bad, and he flunked me pretty badly. I got a "D" in his course from the question.

Mr. SAULNIER. Perhaps you should be flattered.

Senator PROXMIRE. Well, Professor Saulnier, I am flattered that you said that. My self-esteem is recovering a little.

I also welcome you, of course, as a former very distinguished Chairman of the Council of Economic Advisers and one who assisted this committee and the Nation in giving us sound and helpful economic advice for some time. But what concerns me about the thrust of your presentation this morning is this.

I understand that since the end of World War II, dollars have contributed about $16 billion to international reserves. Today total international liquidity is $66.1 billion, of which 40.5 is in gold and 25.6 is in dollars and pounds.

Now you are proposing that we put first priority on correcting our international balance of payments. If our international balance of payments comes into surplus, and I presume we maintain that for a number of years and also if our economy continues to grow and you

would not have our monetary supply grow at the same rate, nevertheless, you would have it grow somewhat; and thirdly, if world trade continues to grow as it has in the past, it will double—what are we going to do then about the need for international reserves?

Isn't there an urgent, and I don't detect that degree of urgency in your paper, an urgent need for some system of providing additional international liquidity?

Mr. SAULNIER. I would say, Senator, that at the moment there is adequate international liquidity provided by gold, by pound sterling balances, and by dollar balances. Indeed, if I understand the affairs of Western Europe, what they have there is a case of excess liquidity.

I am sure you understand that there are substantial dollar balances beyond those that are held by governments in central banks and that this dollar liquidity is what we have made available to the world.

At the moment the problem is to preserve the value of these balances that are providing the existing liquidity; namely, the pound and the dollar. At some future date it may very well be the case that our problem will be a shortage.

Senator PROXMIRE. Let me interrupt you at that point. Isn't it true, Dr. Saulnier, that we know as of a certainty, provided we don't have international deflation and international depression, that if we continue along the trend that has been established over the past 10, 15, 5 years, any term you want to take, we know 2 or 3 years from now, in the very near future, that what you and I agree may be adequate international liquidity at the present time is not going to be adequate and the result is going to be very punishing deflation or some kind of crisis for which we are not prepared?

It seems to me this is the time when we should be working hard and pressing hard to try to bring some rational solution here.

Mr. SAULNIER. I am afraid, Senator, that I could not agree.

Senator PROXMIRE. I am being flunked again.

Mr. SAULNIER. I don't see how you could possibly flunk Professor Galbraith's courses, but you might have trouble with mine. I think our problem in the world today, Senator, is that we are producing excessive amounts of money, that is liquidity. Our problem is not that we are embarrassed for ways and means of expanding our money supply. This is the easiest thing in the world to do.

If I may say so, we have worked out some very sophisticated means of doing it. Our problem is to produce real goods and services.

Senator PROXMIRE. We are doing that.

Mr. SAULNIER. That takes materials and it takes people.

Senator PROXMIRE. My argument is that we have been doing very well. Western Europe has been doing well, the world has been doing well generally. We have been able to make investments in developing countries.

Now it seems to me if we adopt a monetary policy that is restrictive, we feel our prime purpose now is to restrain inflation at a time when we have had a pretty good record, the best record we have had in years, it seems to me on price stability——

Mr. SAULNIER. We are on the brink of making a big mistake here, Senator. What I am saying is that we have to follow a domestic economic policy that will preserve confidence through the world in the value of the U.S. dollar. I must complete this, Senator, otherwise what I am saying here will not be understandable. If we do not do

that, if confidence is lost, then the value of a large part of the world's liquidity, the international value of the dollar will be impaired, and at that point we will indeed have a liquidity problem.

We will have a liquidity crisis, and it is precisely that that we have to avoid. The way to avoid it, I am persuaded, is not by producing more and more supplies of dollars and of pounds sterling, and all the rest. It is to maintain the value of what we presently have.

Now, somewhere along the line we may have the kind of problem that you are talking about, but it is not today's problem. I don't need to tell you we have to address ourselves to today's problems. Lord knows there are enough of those.

Senator PROXMIRE. This is most refreshing because of your ability and your remarkable frankness on this, because almost everyone else seems to say that the main reason why we have to, in our judgment, have a tighter money policy or easy money policy is because of the balance of payments.

What you say, as I understand it, is that we need tighter money because we have to have a sound domestic economic policy and unless we have that sound domestic economic policy, the confidence will be lost in the dollar.

You say even if we didn't have this international balance-of-payments problem, as I understand it, you would still counsel a policy of more restraint because you said the economy is beginning to heat up now, you think we are moving ahead too fast.

Mr. SAULNIER. There are two bases, as I have said, Senator, for the money policy orientation that I have recommended. One is domestic, and the other is international.

Senator PROXMIRE. Right. Now on the domestic score, do you recall with your very long experience in economics, and you may be able to answer this easily in the affirmative, a period during which we have had (1) stable prices, (2) high unemployment, and (3) inadequate utilization of factory resources, and, under such circumstances economists generally have advised that we should tighten our money supply? In other words, we don't have visible inflation at the present time. We have unquestionable unemployment that is high, we are not utilizing our factory facilities, and yet you counsel tight money on strictly domestic grounds.

Mr. SAULNIER. I would counsel it definitely on domestic grounds. Also, as I say, on international grounds. I think you are misunderstanding me on the latter. I make it on both grounds.

Senator PROXMIRE. You don't say that the only reason is international grounds, and that has been the usual approach that we have not——

Mr. SAULNIER. Not at all.

I would say on domestic grounds we would be very well advised not to push our economy too hard in 1965. We are pushing our economy hard now and the budget is going to give it another strong push in the second half of this year.

What I am counseling is moderation today, which does not mean that the money supply is going to go down. It simply means that the money supply won't be increasing quite as fast as it would otherwise be increasing.

Senator PROXMIRE. I understand that; yes.

Mr. SAULNIER. And moderation now in order to keep this expansion of ours going indefinitely. I am one of those who believes, as I say in my testimony, that this expansion could go on indefinitely. I thought it would go in 1960 without interruption, and let me say we came very close to it, very close, indeed.

But if it is to go on, Senator, it will be because we avoid what I have called surges and spurts.

Consider where the economy is at the moment, an average length workweek of 41.4 hours. You have nothing to match that in the Korean conflict period. You have nothing to match it in the expansion of 1955–56. You have nothing since World War II that matches this. Then I would point out the second fact to which I alluded in my testimony, Senator, the very sharp increase in bank credit in the last few weeks.

A number of sources, financial papers, have commented on this. We find the business loans of weekly reporting banks going up very substantially since the first of January, at a time when typically they are declining, seasonally. The signs are that we are already a bit overheated. Now you speak of capacity. I spent part of Tuesday morning, Senator, with a group in New York City of one of our larger industries.

I think it would be better if I did not identify the particular one, but I would be glad to do so for the committee's information if they wish, but that is not really important. It is a very large industry.

And they are operating at this time at 97 percent of 6 days' capacity of their plant. Sure, they can work 7 days. But that is not the way we figure capacity. As we figure capacity, there is industry after industry in this country operating very close to 100 percent; that is close to workable limits of capacity. So, I say, don't push your luck too hard.

Senator PROXMIRE. My time is up but I do want to say as one who voted against the tax cut and politically suffered from it, although I think I was right, I am somewhat concerned with the fact that you take this strong position that we are pressing our luck too hard and yet you advocate a cut in the corporate income tax.

Mr. SAULNIER. Not today.

Senator PROXMIRE. At any rate, it seems to me that it is so easy for us to advocate that we cut taxes. Everybody wants that and then advocate that we restrain inflation by a tighter monetary policy. I—but I think my time is up.

Representative REUSS. I will recognize Mr. Ellsworth now.

Representative ELLSWORTH. Thank you very much, Mr. Chairman. Professor Saulnier, it certainly is a real pleasure to have you here this morning and to have this very refreshing and searching testimony you have offered us.

I want to say that I particularly appreciate your advising us, and indeed, the whole Government, to emphasize the pluses, building up on our plus strengths in this export and balance-of-payments situation so that we don't have to retrench where we don't want to on some of the minuses.

I was glad, of course, to have you mention as one of the pluses the possibility of enlarging our export of consumer items. I would like to say that I, from my point of view, want to emphasize the importance of

not only building up but also guarding against the cutback in our oversea commercial dollar markets for our agricultural products, because this is something that very definitely is happening to us all the time, as I am sure you know, and from my point of view it is of critical importance.

Of course, I fully agree with you that the long-term remedy to the problems we are talking about is to improve our ability all over the whole spectrum of our production to export into world markets. I was especially glad to see your analysis of the overall effect of private capital investment in which you emphasized the export-inducing effect of private oversea investment.

Mr. Reuss questioned you about the export-reducing effect of private oversea investment. I would like to ask if you don't agree that there is also a very substantial export-reducing effect that flows from public capital oversea investment?

Mr. SAULNIER. That could be.

Representative ELLSWORTH. I may say that we here in the House——

Mr. SAULNIER. I would expect somewhat less than in the case of private capital investment flows.

Representative ELLSWORTH. We here in the House hear a great deal from our friends from the Southeast, who complain of that very effect so far as the textile industry is concerned; that is, the export-reducing effect, and, indeed, the import-inducing effect of some of our public oversea capital investments.

Mr. SAULNIER. I would say, Congressman, to the extent that public capital outflows finance conventional production operations, steel, and textiles, and so forth, the line of demarcation between their impact on the balance of payments and the impact of a private capital outflow tends to become very dim.

Representative ELLSWORTH. Thank you very much.

Now more for clarification than anything else I would like to ask you about your position in response to questions from Senator Proxmire about your not favoring or not feeling that there is any real, underlying need for an increase in international liquidity.

My confusion stems from the fact that I thought I heard you say in response to some questions from Chairman Patman that you felt that we needed some fundamental improvements in our international currency reserve system and indeed I made a note of that very phrase. Is there any confusion now between what you said to the one and to the other?

Mr. SAULNIER. If there is it is because I have not made myself clear.

Representative ELLSWORTH. If you would, please.

Mr. SAULNIER. We are now discussing with our friends and allies around the world ways and means of improving the machinery of international finance.

And we want to continue those discussions. Any improvements that can be made in the machinery I will be most interested in, and will want to favor insofar as they are constructive. The last thing I want to say, Congressman, is that I think it is impossible to improve on what we have. I would like to say, on the other hand, that what we have is not a bad system and I would like to say, also, that I hope when these improvements are made they will be made within the context of the International Monetary Fund. I don't know of a single

thing that has been suggested in any one of the plans that could not be done through the International Monetary Fund, where you have 20 years of experience and you have a highly competent staff and all the knowledge and contact with this sort of thing that one could possibly wish for.

So, I am open minded—could not be more open minded—on this subject. So much for machinery.

The second thing I would say is that when we invent some machinery let us not think that our need is for easier ways of creating money. That is the simplest thing in the world to do. The problem is to maintain the value of the money that you have. And that is not easy to do.

So, I focus my comments on maintaining the value, the domestic purchasing power of money. From this follows the external purchasing power of the moneys that we have in the world. And two of these moneys constitute our liquidity resources, the dollar of the United States and the pound sterling of the United Kingdom. And when I speak, as I do, about maintaining the domestic purchasing power of the U.S. dollar, I have in mind maintaining the value of that which presently constitutes the major component of international liquidity reserves.

This is the hard thing to do. It is not hard to invent machinery. Somehow or other people concentrate on the easy things to do and it is easy to understand why. I am saying, let us concentrate on some of the hard things to do. If we ever find ourselves with a large surplus in our balance of payments, which I honestly don't expect us to do, we will face the problem when we come to it. But it just does not happen to be today's problem.

As has been said many times, you know, there are so many problems to worry about we don't have to invent them.

Representative ELLSWORTH. That is right. Against that background do you look with favor or with unfavor on some of the proposals that have been mentioned for creating some new kind of international reserve currency like the so-called CRU?

Mr. SAULNIER. It is quite possible that that might be worked out to be useful, quite possible. But I want to say, Congressman, that now we are talking about some very critical and delicate technical points. I have had no part whatever in the conversations and discussions that have gone on with reference to the CRU or other monetary units. Accordingly, I really don't feel competent to comment specifically on that proposal.

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

Representative REUSS. Senator Jordan.

Senator JORDAN. Mr. Chairman, Dr. Saulnier, I want to add my voice to those of my colleagues in welcoming you here before this committee. Your testimony is always of great value to us. I do appreciate the frankness and clarity of your exposition and the forthrightness of your defense of your principles.

I happen to agree with you quite thoroughly in your presentation. I am pleased that you have selected this very vexing problem of international payments with which to deal with this morning. Most of the items I had in mind have been touched upon but I am caught with

this discussion you have just brushed over here in your statement with respect to inflation in Western Europe.

I presume this would prevail then throughout a number of the foreign countries. You are discussing another matter but you say that in Western Europe—

> prices and wages have risen sharply there in recent years. Price indexes show increases of 5 to 20 percent, depending on the country we have in mind and whether we are talking about consumer or wholesale prices; and that labor cost indexes have risen in some cases by as much as 40 percent.

Now what period of time are you talking about in these recent years?

Mr. SAULNIER. Those increases have occurred mainly since 1961 and 1962.

Senator JORDAN. Then I would assume that this is a much higher rate of inflation than has been obtained in this country?

Mr. SAULNIER. Yes, indeed.

Senator JORDAN. In that same period of time?

Mr. SAULNIER. Very much higher. We have, as a matter of fact, done very well while the Western Europeans have done poorly. I have said of this once or twice that it is a possibility that their sins could be our salvation. And to a certain extent that is how it has worked out. But we have not worked hard enough on our own salvation, although I must say they have done their part to help us.

Senator JORDAN. That is what I am leading to. In the very nature of things, their rate of inflation being higher than ours would tend to work in our favor to make our competitive position much better in that export market, would it not?

Mr. SAULNIER. It does indeed, it has precisely that effect.

Senator JORDAN. So it has the effect of closing the gap to make that world market more available to our domestic producers.

Mr. SAULNIER. It does precisely that.

Senator JORDAN. Then I am intrigued by your preference of corporate tax cuts because you say, and I would agree, that this would do something positive on our side to give us a more competitive advantage in foreign markets if we could produce goods cheaper and get a sales force that could market them cheaper and so on and accomodate our production to the markets abroad.

But how soon will this gap be closed by reason of these two factors, their higher rate of inflation and the proposal you make for improving our competitive position. When do you expect parity might be reached in that regard?

Mr. SAULNIER. Well, in the first place, Western Europeans at the moment are taking measures to check cost and price inflation in their countries and they are doing pretty well at it. So I would say, first, that we can't depend on them to solve our problems for us by allowing themselves to be drawn into a great inflation.

We have got to work at our own salvation, ourselves. The key to this is to maintain a relationship between wage increases and productivity improvements in the U.S. economy that will at least make stable prices possible and, if possible, enable price reductions.

Now I would like to allude to the matter of taxes because I am not sure that I made myself clear on this.

I also had reservations about the tax cut in 1964. I was mollified only when it became clear that we were going to put a restraint

on expenditure increases in 1964 and even then I went along only reluctantly with the tax cut as it was enacted. I would have preferred to see it spread over a longer period. But the American public, who are very smart in these things, fortunately—I don't know how they would make out in Professor Galbraith's course, but they have learned their economics well—saved in 1964 and thus they moved part of the effect of the tax cut forward and spread it into 1965.

I read also that they overpaid their taxes a bit, an extraordinarily prudent thing for them to have done. To the dismay of many of my Keynesian friends the situation is a little different than had been anticipated, but the consumer did the right thing, all the same.

Should we have more tax cuts now? Well, on this question one is to an extent in the same position as when the tax cut was made in 1964. Excise tax cuts have been to all intents and purposes promised. Once these things get into the mainsteram of thinking it is not too easy to say "No." It is not even safe to say "No," in some cases. So, I am afraid it is not a case now of a choice between a corporate income tax cut and an excise tax cut. I think the die is pretty well cast.

But let us put additional corporate tax reduction on the agenda and let us move forward with this as soon as it is consistent with: one, economic stability; and two, fiscal prudence.

And I would have to tell you that I don't think it would be consistent with either of those today. Maybe next year. I hope so. But today, in view of the fact that you have these excise taxes, so to speak, in the works, if I may use that expression, and because you have an expenditure budget with a $7 billion increase in it, I would say that this is not a tax-cutting year.

Senator JORDAN. Thank you, sir. Thank you, Mr. Chairman.

Senator PROXMIRE. I would like to ask a couple more questions. I would like to tell you, Mr. Saulnier, the only reason that some members have left was that there was a call of the House which made it mandatory for them to go to the floor.

You did provoke a question which I cannot resist asking since you were the principal economic adviser to President Eisenhower in 1960. You said that you expected economic conditions to continue to improve and to go on up in 1960 and 1961 and they did not. I would like to ask why?

Mr. SAULNIER. There are a lot of reasons for that and I will be glad to expand on them. In mid-1960 our economy was pretty flat. In some respects it was showing minuses. In other respects it was showing pluses. Personal income was still rising a bit, but very slowly.

I said, and said repeatedly, at that time, Senator, that I thought the next—and I remember my words, they were not used, may I say, casually or carelessly—I said, "I expect the next major move to be up."

Now I said major move because I did not forgo a little wiggle in the curve, you know. That could happen. I had in mind the next major move. I would have to say that I was wrong. There was a move down, which was a major one, though it was small. It occurred, Senator, only in the fourth quarter of 1960 and the first quarter of 1961.

If you look at the annual figures of GNP, there was no move. If you look at the quarterly figures, there was a decline. Now why was it? And here I am directing myself, at long last, to your question. There

are two reasons: one, the atmosphere at that time in our economy was really very bad. We were in the midst of a public electoral dialog and everybody was being told that the United States was on the downgrade, our economy was going to pot, our prestige around the world was never lower, et cetera, et cetera.

We had a missile gap, we had every kind of gap you could imagine. I don't know whether to call it sadism or masochism, but it was painful, believe me. And mind you, it had the effect of undermining confidence in our economic outlook. This was a terrible atmosphere, believe me.

Senator PROXMIRE. Let me ask you this, that was no different from any other presidential campaign in which the incumbents defend their position and the economic state of the country is being challenged. It always is in presidential campaigns; is it not?

Mr. SAULNIER. No; I think we had a very severe case of it. I would say that qualitatively it is like it usually is. But the quantity, the degree, was different.

Now the second point is this: We had, for reasons that are not easy to understand, a slowing up in the rate of accumulation of business inventories. I have searched into that, myself, a good deal, and it is not easy to understand why, because sales were good.

As a matter of fact, in this period you will find that final sales—that is, GNP minus inventory—never declined. It was an inventory recession. I cannot explain it in any way except in terms of, shall we say, a recession of confidence.

Senator PROXMIRE. I have just one final question.

Robert Marjolin, the top economist for the Common Market, indicated recently that the adverse balance of trade of the Common Market was about $3 billion. Now you advocate that our surplus balance of trade, our favorable balance of trade, be increased.

I would assume much of this would be at the cost of the Common Market. How adverse can they get?

Mr. SAULNIER. But their balance of payments as a whole is favorable.

Senator PROXMIRE. Yes, indeed.

Mr. SAULNIER. They could be substantially more adverse in their trade balance and still not have to be embarrassed in their international financial position.

The increase in our trade surplus at this point in time would not be a problem for the Western European countries. By strengthening the position of the dollar, it would I think strengthen the whole Western alliance.

One of the reasons why I am recommending that special attention be given by the committee to the international payments problem is this: I am an internationalist; I like to see barriers to trade, barriers to the movement of people, barriers to the movement of capital funds reduced. I am a one world man, if you will, and someday I hope to see the concept of one world rediscovered.

Now the danger is that when we get into balance-of-payments problems, the remedies that we take are essentially the remedies of isolationism. We put barriers between ourselves and the rest of the world. The British put a 15-percent surtax on, which is in effect doubling their tariffs.

We put a 1-percent tax on the export of capital, and so forth.

So really, what is at stake in the balance-of-payments problem is the integrity, the closeness of economic relations among ourselves and our Western allies. It is vitally important that we strengthen these relationships, not weaken them.

Senator PROXMIRE. I want to thank you very much, Professor Saulnier. You have been extremely helpful and lucid in your presentation.

The committee will recess until tomorrow, Friday, when we will reconvene at 10 o'clock in this room to hear Chairman Martin of the Federal Reserve System.

Mr. SAULNIER. Thank you, sir.

(Whereupon, at 12:30 p.m., the committee recessed until 10 a.m., Friday, February 26, 1965.)

THE PRESIDENT'S ECONOMIC REPORT

FRIDAY, FEBRUARY 26, 1965

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

The Joint Committee met at 10 a.m., pursuant to call, in room AE–1, the Capitol Building, Hon. Wright Patman (chairman) presiding.

Present: Senators Douglas, Proxmire, Jordan, and Talmadge, and Representatives Patman, Reuss, Curtis, and Ellsworth.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton Gewehr, administrative clerk.

Chairman PATMAN. The committee will come to order. This morning the committee has the privilege of hearing from the distinguished Chairman of the Board of Governors of the Federal Reserve System, the Honorable William McChesney Martin, Jr.

Mr. Martin is the chief official of the most powerful monetary organization in this country and hence in the world. It controls the supply of money and credit in the American economy and in this capacity carries out a function charged to Congress by the Constitution and delegated by it to the System.

No other single organization has so much power to produce economic well-being or economic disaster for the Nation as the Federal Reserve System; considering the large role the American economy plays in the world it would not be an exaggeration to say that the actions of this organization have tremendous potential to the well-being not only of this Nation but the world.

The power of the Board of Governors and the Open Market Committee to reinforce the economic policies of the Nation or to frustrate them provide ample justification for this committee to regularly seek the views of the Chairman of the Board of Governors before making our recommendations to the Congress.

Mr. Martin, we welcome you back to the Joint Economic Committee and look forward to listening to your analysis and recommendations. You may proceed with your statement, sir. You may introduce the gentlemen accompanying you for the record, if you please.

Mr. MARTIN. On my right I have Guy Noyes, who is an adviser to the Board, and on my left is Mr. Ralph Young, who is the secretary of the Federal Open Market Committee.

Chairman PATMAN. I believe you have a prepared statement. You may proceed as you desire.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH YOUNG, SECRETARY, FEDERAL OPEN MARKET COMMITTEE; AND GUY NOYES, ADVISER TO THE BOARD OF GOVERNORS

Mr. MARTIN. Thank you, Mr. Chairman.

Today my remarks will be directed primarily to financial development because there is little I can add to the more general reviews of the economy's progress which you have already heard. I share fully the satisfaction others have expressed about the achievement of a fourth year of vigorous expansion in the output of goods and services. And I am also pleased that we were able to show further progress in reducing, at least a little, the unemployment rate. That we accomplished so much within a general framework of price stability is a matter for special gratification.

However, as has been brought vividly to our attention in recent weeks, our slow progress toward a solution to our balance-of-payments problem has not been so gratifying and failure to bring about a significant improvement consitutes a challenge of first importance to our national well-being. The whole posture and effectiveness of our foreign economic policy hinges on world confidence in the dollar. I would like to return to this problem later in my statement and make a few additional comments, but before doing so I want to comment on the domestic aspects of the economy.

To assess with precision the role of one segment of public policy in the broad sweep of economic developments is always difficult. For example, we all speculated before the fact as to what might be the impact of the tax changes which went into effect last year. Even with the benefit of hindsight, it is very difficult to say how much of the expansion in activity last year flowed directly from the stimulus of tax reduction. It is equally difficult to say what part monetary policy played in last year's economic advance. Assessments of this kind will always be matters of judgment. But I think we can agree that both fiscal policy and monetary policy contributed positively to the year's outcome.

As to credit market developments during 1964, there was relatively little change over the year in either the availability of credit or the cost of credit in markets which are most closely related to domestic economic activity.

Total funds raised last year amounted to a little over $71 billion—up from about $62 billion in 1963, and $58 billion in 1962. The pattern of flow within this sizable increase in the total was roughly comparable to that of other recent years.

To take a few examples, the Federal Government raised about $6 billion in the calendar year, as compared with $4.8 billion in 1963, and $7.5 billion in 1962. Consumer credit increased $6.7 billion—the same amount as 1963, and more than $5.5 billion in 1962. State and local governments added $6.5 billion to their indebtedness, as compared with $6.7 billion in 1963, and $5 billion in 1962. Additional borrowing on one to four family home mortgages amounted to about $16 billion, as compared to $15 billion in 1963 and $13 billion in 1962. As you can

see, all of the figures for 1964 are roughly in the same order of magnitude as those in other recent years and the overall increase is widely distributed.

Much the same observation might be made with respect to the sources of funds. The flow of financial savings in the form of time and savings deposits at commercial banks and at other savings institutions remained high and little changed, amounting to about $29 billion in 1964, as compared with $28 billion in each of the preceding 2 years. Private insurance and pension fund reserves increased by $10.5 billion last year, as compared with about $10 billion in 1963 and $9 billion in 1962. Direct financial investment by the public was larger than in other recent years—$14 billion, as compared to around $10 billion in 1963 and $9 billion in 1962. Generally, we see that the changes which occurred in the pattern of savings flows were not dramatic, although the year to year gains were varied. Increases in the public's holdings of demand deposits and currency financed $6.1 billion of the total flow, as compared with $5 billion in the preceding year. This was related to a 4-percent increase over the year in the conventionally defined money supply, as compared with 3.8 percent in 1963.

As I have already suggested, these shifts in the flow of funds were not accompanied by any change in the structure of interest rates or in credit availability of great significance for the domestic economy. The yield on long-term U.S. Government bonds fluctuated between 4.11 and 4.20 percent, and was close to the middle of that range at yearend. Yields on Triple A State and local government issues fluctuated in a range of 2.99 to 3.16 percent, and ended the year at the low point of that range. Triple A corporate bonds moved between 4.35 and 4.45 percent, closing near the top of the range. After moving in a very narrow range throughout most of the year, the rate on 90-day Treasury bills rose in the fall, especially in conjunction with the change in the Federal Reserve discount rate in late November, and at yearend it was near the top of the 3.43- to 3.86-percent range for the year as a whole.

I believe it is fair to say that the very moderate changes in long-term yields and in fund flows reflected primarily in the interplay of market forces and not the modest changes that were made from time to time in monetary policy, primarily with a view to maintaining as firm conditions as practicable in the short-term money market for balance-of-payments purposes. However, the overall effect of our policies was to permit credit to expand in response to the demands of a vigorously growing domestic economy without significant upward adjustment of the cost of contractive adjustment in the availability of credit.

At the time, this policy seemed to me to be the most appropriate one and, in retrospect, it still seems to me to have been appropriate. I am reasonably certain that a more stimulative monetary policy would not have been desirable. It is not equally clear to me that even in terms of domestic developments alone we may not wish we had exercised somewhat more restraint, especially on the very rapid growth of money and credit which occurred during the early summer. Since that time the rate of expansion in the money supply has, in fact, moderated, and the rate of bank credit expansion has been closely geared to the inflow of time and savings deposits. We may suspect that credit

growth in 1964 facilitated unsustainably high rates of activity in some areas, and to the buildup of dormant but dangerous pools of liquidity in the economy, but it is not yet evident that this was the case.

There is evidence that the high rate of credit growth last year, as well as in the immediately preceding years, was not accomplished without some deterioration in the quality of credit. In itself this is not a cause for alarm. As institutional lenders have been pressed to employ the large flows of funds that have come to them it was to be expected that they would make some loans on more liberal terms than were heretofore acceptable. So long as these are scattered in well-balanced portfolios and protected by adequate reserves, they do not endanger the financial structure. But if they are concentrated in some institutions or in certain local areas they can cause real trouble.

Senator DOUGLAS. Mr. Martin, I don't want to interfere with your testimony but this is a very interesting statement. Are you referring to building and loan institutions?

Mr. MARTIN. I am referring principally to the San Francisco National Bank and the Brighton National Bank.

Senator DOUGLAS. Are you referring to the savings and loan institutions, too?

Mr. MARTIN. And some of them also; yes, sir.

I believe that the financial community is now fully alert to this problem and its potentialities—but we must be careful in our monetary policy not to encourage lending practices that, in the supervision of financial institutions, we seek to prevent. Too much pressure to expand aggregate demand through additions to the flow of funds in credit markets could have this effect.

Economic developments are never exactly as one might wish them to be—and some maladjustments are no more than evidence of necessary and desirable changes that are part of the growth process.

The shifts of capital and other resources from obsolete to more productive uses that are essential to growth are smoothed and speeded by the ready availability of credit. I believe our policies helped the credit mechanism to perform this useful function in 1964. In other words, I think that monetary policy did what it could and should do to facilitate healthy economic growth within the United States. In our effort to try to do all that we could, I only hope that we did not do a little more than we should have.

Whether it could have or should have, it is now clear that monetary policy did not prevent a large increase in capital outflows from the United States in 1964. While it is true that we were still able to show some modest improvement by reducing the deficit from $3.3 billion in 1963, to $3 billion in 1964, the substantial improvement that we all hoped for and might otherwise have achieved was wiped out by a dramatic rise in capital outflows. Total capital outflows increased by almost $2 billion—from about $4 billion to about $6 billion. Had it not been for this increase, our deficit would have dropped to $1 billion—progress that would have been generally regarded as encouraging, both here and abroad.

The large increase in our capital outflow was associated with a substantial advance abroad in both short-term and long-term rates and a marked curtailment in the availability of credit in major foreign markets. At the time we were experiencing this mounting capital out-

flow, an adverse payments balance for the United Kingdom put the pound sterling under strong pressure in international markets resulting in further large drains on Britain's monetary reserves. That country was obliged to take a number of emergency steps, including the establishment by its central bank of a discount rate of 7 percent. To support the pound in international markets, the Bank of England arranged credits with other central banks and the BIS amounting to about $3 billion.

In these circumstances and in recognition of the advances in short-term rates that had been occurring in other international markets, the Federal Reserve discount rate was raised from 3½ to 4 percent. At the same time ceilings on the interest rates that banks are permitted to pay on time deposits of over 90 days were raised to 4.5 percent. Short-term rates in our money market promptly moved upward about a quarter of a percent in adjustment to these changes. It is impossible to say how large the capital outflow in the fourth quarter might have been if we had not taken the actions when we did. All that we know is that in spite of whatever inhibiting effect may have come from these actions, and the accompanying rise in short rates, there was a further rise in lending and investing abroad.

I realize that it is always possible to play a sort of numbers game with the balance-of-payments statistics, in which one can show that a substantial reduction in any important component of the gross flows of funds abroad would wipe out or drastically reduce our deficit. This is true of foreign aid, of our military expenditures overseas, of tourist expenditures, and so on. The important fact to bear in mind is that it was our capital outflow that rose so spectacularly in recent months.

This is why the President's program to correct our balance-of-payments deficit places special emphasis on capital flows and on bank lending in particular. Bank lending to foreigners last year increased by over $1 billion, bringing it to double the rate which prevailed in 1963, and about quadruple the 1962 rate.

In the light of these facts, it seems clear to me that the program launched by the President addresses itself to the core of the problem. To accomplish its ends, it is relying heavily on voluntary cooperation by banks, other financial institutions, and nonfinancial businesses. The Federal Reserve System has a major role in this program and is already pursuing vigorously its assignment from the President.

It is no secret that some skepticism has been expressed both here and abroad as to whether such a voluntary program can succeed. No one can say for certain until we try.

The advantages of this voluntary approach are obvious. It interferes less drastically with the principles of our economy, based on private initiative and the market mechanism, than would a system of direct controls. It can be put into effect much faster than taxes or statutory regulations on oversea lending and investment, and it can be much more flexible in dealing with special situations.

While it does not relieve us of the necessity of pursuing fiscal and monetary policies appropriate to the correction of our payments deficit, it may permit somewhat greater latitude in adjusting such policies to stable and sustainable domestic economic expansion. The risk is equally obvious. We cannot be certain that we will obtain, voluntarily, the cooperation which is essential to the success of this sort of program.

Bankers and other businessmen feel, as they should, a strong sense of responsibility to maximize the earnings available to pay interest and dividends to their depositors and shareholders. But more and more, it seems to me, they are prepared to interpret this responsibility broadly and to recognize that policies which are in the national interest may be more beneficial to them, even though they may not maximize profits in the short run. I am encouraged by the response that we have had thus far. The bankers and others with whom I have discussed the program seem not only willing but determined to make the program a success.

However, I think we must all follow the progress of this program and related developments in our balance of payments closely as the year progresses. If at any point it apears to us that we are not making the gains envisaged in the President's message, we must all be prepared to take whatever additional measures are needed, including of course, a less expansive overall credit policy. There is no doubt in my mind that 1965 must be a year in which we show substantial progress toward the solution of our balance-of-payments problem.

Let me say a few words about economic developments since the turn of the year, since January 1. Unfortunately, our ability to judge the underlying trends in the economy is complicated by an extended dock strike that has paralyzed shipping at east coast and gulf ports, and by the prospect of a work stoppage in the steel industry.

In the aggregate, we do know that economic activity has continued to rise. Following the large gains in November and December, when auto output recovered from strikes, industrial production rose somewhat further in January. Unemployment edged down to 4.8 percent. Bank credit rose vigorously, reflecting a large inflow of time and savings deposits that appears to be continuing in February. The money supply expanded moderately in January—at an annual rate of about 3 percent—but showed no further growth in the first half of February. We know from experience, and I would warn you, that very little significance should be attached to week-to-week and even month-to-month fluctuations in this rate, however. Movements in one direction or the other often reverse themselves in the subsequent period.

Conditions in money markets have firmed somewhat in recent weeks and the 3-month bill rate has moved up close to the 4 percent discount rate. As those of you who have heard me discuss the subject before are well aware, I feel strongly that too much emphasis should not be placed on free or net borrowed reserve figures as indicators of monetary policy. Nevertheless, let me just mention that free reserves have been somewhat lower on average and we did report a minus figure in one recent week. The more meaningful observation, I think, is that the whole complex of factors that make up what we call the tone and feel of the market have been slightly firmer. While there has been some uncertainty as to market prospects for longer term securities, actual prices have moved very little and the average yield on long-term Government bonds is still close to the level that prevailed at the turn of the year.

Commodity price behavior is perhaps the most difficult of all developments to interpret with confidence. For the last several years

there have been efforts from time to time by suppliers of industrial materials and products to make upward price adjustments. More often than not these efforts failed, with the result that overall averages remained substantially unchanged. Since the middle of last year, when market prices of sensitive industrial materials moved up further, more of the price increases in industrial products have held than was the case earlier, and as a result the averages of both industrial material and product prices have edged up. Thus far, the movement in these averages could certainly be described as moderate, and the tendency for more price increases to stick may be related to the high rates of activity in some lines, associated with steel strike anticipations. When this added stimulus is withdrawn or reversed, even the mild uptrend that we have seen recently may disappear.

Having said this, let me add that I cannot avoid the feeling that we have been, and still are, sailing very close to the edge in this area. Expectations play an important role in price behavior and the expectation of continuing price stability is vital to its current realization.

As I have reiterated many times, inflation is a process and not just a condition. We must expect that markets will continue to be tested and that if we fail to maintain a situation which is conducive to price stability, we could find ourselves caught up very quickly in an inflationary spiral. Such a development would seriously threaten both our program to bring our international payments into balance, and the prospects for continued expansion in our domestic economy.

There is, inevitably, an element of "brinkmanship" in our laudable efforts to push our economy closer and closer to its full potential without straining it. It will require the best efforts of all of us to achieve balance in both our internal and international economic affairs in the year ahead.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Chairman. I want to ask you about the gold situation. I noticed in New York Times this morning that U.S. Gold stocks dipped $262 million. Then down in the article there is something on which I want to get some information from you.

It says that officials in London confirmed that private buying in London had been relatively heavy in January. What do they mean by private buying, Mr. Martin? Does that mean that private individuals and corporation can, through the central bank there, acquire gold?

Mr. MARTIN. Anybody can go into the London gold market. There is no limitation.

Chairman PATMAN. In other words, they can reduce our supply by raiding it in London?

Mr. MARTIN. They can purchase it in London, yes.

Chairman PATMAN. Now this thing is getting serious, you know. West Germany has gone in on this deal, too, I understand, and is siding with France and expects to get all the gold from us they can.

If you are convinced that there is a raid by these central banks and others in Europe, what is going to be our alternative? Will it be controls, embargoes, or what?

Mr. MARTIN. I would certainly hope that we would never get ourselves in a position, Mr. Patman, where we would have to place an embargo on gold.

Chairman PATMAN. What is going to happen if West Germany and France and all these countries are letting private individuals get gold? Of course, we only deal with central banks, like the central bank in London, and don't deal with individuals and corporations.

Mr. MARTIN. That is correct.

Chairman PATMAN. But if the individuals and corporations can go to the London Bank and get gold, and then they call on us for that gold, it is the same thing as individuals and corporations in London taking our gold, is it not?

Mr. MARTIN. Well, they have to use hard convertible currencies to buy in the London gold market. As long as there is confidence in currencies, there is no incentive to tie them up in gold that produces no income.

Chairman PATMAN. If you are convinced that there is a deliberate raid, a conspiracy to take our gold, what are you going to recommend that we do?

Mr. MARTIN. We have been constantly cooperating with our counterparts in Europe, the central banks of Europe, to prevent raiding.

Chairman PATMAN. To prevent raiding?

Mr. MARTIN. We have, indeed.

Chairman PATMAN. I know, but it is going on right now, is it not?

Mr. MARTIN. I don't see any evidence of it. I don't know this article you refer to.

Chairman PATMAN. There is one other thing I want to ask you here. The figures indicate that the value of all of our oil imports exceed oil exports by a billion dollars a year, and tanker transportation cost paid to foreigners and U.S. military purchasers of foreign oil brings the Nation's deficit due to petroleum to a billion and a half dollars a year. Would you consider that about correct?

Mr. MARTIN. I would think so. Mr. Patman. I don't know.

Chairman PATMAN. I want to invite your attention to this fact, something that we have let go entirely too long.

You know, the depletion allowance in this country—we have an argument for that because of depleting our resources here in the United States. I say we have an argument for it, Senator Douglas, I didn't say how much; whether it should be higher or lower. But what argument do you have for giving it to these oil companies that are importing all this oil, and it is very much to their advantage and benefit to do so, because it is produced at such a low price and they are getting depletion allowance in these foreign countries.

What justification can we have for giving depletion allowance to a company that is producing oil in Venezuela or Kuwait and all these other countries?

Mr. MARTIN. Mr. Patman, I am not running the tax policy of the Government.

Chairman PATMAN. Well, you are a well-informed man. You keep up with current events and certainly things that involve our balance of payments and this involves our balance of payments. It is a major item in international finance and you are an expert on that.

Mr. MARTIN. I have never taken an active part in tax policy.

Chairman PATMAN. Of course that is one answer you can give but I am not satisfied with it. You are not as forthright as you are usually on things.

Mr. MARTIN. You would not suggest that I take over the Treasury's functions, would you?

Chairman PATMAN. Oh, no, you are changing the subject entirely. However, you have taken over the Treasury's functions in so many things that this would be minor in comparison.

Now, as to the gold, are you not willing to say what our alternatives would be?

Mr. MARTIN. I have no suggestions on that.

Chairman PATMAN. You have no suggestions on that?

Mr. MARTIN. No, sir.

Chairman PATMAN. It looks to me we are on the brink of trouble now, if these newspaper items are correct.

Mr. MARTIN. We are in trouble.

Chairman PATMAN. You do admit that?

Mr. MARTIN. I do, indeed.

Chairman PATMAN. You are not suggesting any alternatives?

Mr. MARTIN. We have a very active program on our balance of payments which the President has proposed and the Federal Reserve is going to do everything in its power to make it work.

Chairman PATMAN. But you don't know much about this billion and a half oil dollars?

Mr. MARTIN. I didn't say I didn't know anything about it. I said that the depletion allowance, that taxation is not my——

Chairman PATMAN. That is a major part of it. By reason of the depletion allowance they are able to bring this oil in at such a cheap price they don't use our local oil. They bring the oil in from the outside because they have such a terrific advantage by reason of that.

Mr. MARTIN. I would certainly hope the Treasury will do everything they can to cooperate with this program to bring the balance of payments around.

Chairman PATMAN. Our interest rates are higher than at any time since the early 1930's. The President's Economic Report points this out which I am glad to see. Now we all know that the Federal Reserve controls rates. My question is simply this: How far do you think these interest increases can go?

In my opinion, they are already jeopardizing our economic well-being, and there is disturbing signs that another further increase in interest rates is in the making. What I want to ask is, What is your expectation regarding long-term interest rates on Government bonds?

Mr. MARTIN. I am very loath to make any specific forecast, as you know, Mr. Patman. I think that the volume of savings, the flow of savings, the availability of money is such for the foreseeable future that I don't expect much in the way of an increase in long-term interest rates.

Chairman PATMAN. It doesn't take much of an increase. They are right at the top of the ceiling right now. They are 4.24 and the ceiling is 4.25.

Mr. MARTIN. They are very close to the 4¼ percent.

Chairman PATMAN. You say you are not expecting much increase?

Mr. MARTIN. That is right.

Chairman PATMAN. Are you expecting to ask that 4¼ percent be taken off? The limitation?

Mr. MARTIN. That is not for me to say; but if I were the administration, I would seek its removal. I supported it very vigorously the last time it came up.

Chairman PATMAN. Would you let Government bonds go to 6 percent?

Mr. MARTIN. I don't think they would have to go to 6 percent.

Chairman PATMAN. You would not do anything to stop them if they went there?

Mr. MARTIN. If the forces of the market were such and our general needs required it. I don't think it is a case of high interest rates or low interest rates. I think we are seeking the right interest rate to achieve equilibrium in our economy. I have always testified up here that I favor as low interest rates as we can have without producing inflation.

Chairman PATMAN. I know you have said that, Mr. Martin.

Mr. MARTIN. And I believe it.

Chairman PATMAN. You have not acted that way.

Mr. MARTIN. Well, that is a matter of judgment.

Chairman PATMAN. I think the record shows it.

Mr. MARTIN. No, wait. You and I have had this colloquy many times. I can't find any time when you have been in favor of any increase in interest rates. But I have frequently been in favor of lower interest rates.

Chairman PATMAN. I would like to know those times, I sure would.

Mr. MARTIN. I was up here in 1957, we reduced the interest rate. We got the bill rate down.

Chairman PATMAN. That was in a depression.

Mr. MARTIN. All we are trying to do is to have a stabilizing influence, sir.

Chairman PATMAN. I accept your word for it; yes, sir. Now you mention the President's appeal on funds going outside the country through commercial bank lending, I assume. Do you know how successful it will be; it is a voluntary plan.

I agree with you that there is no way to determine it. I noticed that the Federal Reserve has joined in and most of the large banks have joined in, which is very fine, but the American Bankers Association is the most powerful group in the United States of America. They can come nearer stopping laws being passed, come nearer getting laws passed than any group in the United States because they not only have the bankers on their side but they interlock with all these big corporations that have lobbyists here on Capitol Hill, hundreds of thousands of them and they can mobilize the strength of the entire lobbying power on Capitol Hill any time they want to.

So a big organization like that, it occurs to me, should take some interest in a campaign that the President wanted. Have they taken any interest in it, Mr. Martin, to your knowledge?

Mr. MARTIN. Yes.

Chairman PATMAN. As an association?

Mr. MARTIN. As an association.

Mr. PATMAN. That is very encouraging to me.

Mr. MARTIN. Charls Walker, executive vice president, attended the meeting Wednesday at the Federal Reserve Board.

Chairman PATMAN. Did the association take any stand in it?

Mr. MARTIN. I don't know whether they adopted a formal motion but all of the banks——

Chairman PATMAN. If they will we have it won because they can put it over.

Mr. MARTIN. I am afraid you are exaggerating their influence.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Martin, I always enjoy your testimony. I think I even enjoyed this colloquy between you and Mr. Patman which seems to be an annual event. I just want to review one little aspect of the balance of payments to be sure my own thinking is straight.

The balance-of-payments deficit widened seriously around 1957 but there are two ways that we can settle our deficits in the balance of payments, either with gold or with dollars. Is that a fair statement?

Mr. MARTIN. Yes. Since 1949 we have had an adverse balance, year in and year out. Most of that balance has been settled in dollars rather than in gold.

Representative CURTIS. Right after 1957 there was quite an amount of gold outflow and a great deal of attention was directed to that aspect of it.

Mr. MARTIN. That is right.

Representative CURTIS. What I am leading up to is that it seemed to be entirely too much attention was directed to the symptom of gold flow. The symptom was corrected to some degree during the past 4 years as the gold flow was cut down, but the dollar holdings continued to rise. This is, in effect, a time bomb, as I have described it, that is now with us.

Would you comment on that figure of speech that I have used? Do you disagree with it?

Mr. MARTIN. It is certainly unfortunate that we had an improvement last year of only $300 million in our deficit. We went from $3.3 down to $3 billion in a year. We have not made the progress since President Kennedy's balance-of-payments message on July 18, 1963, that we had hoped we would make.

Representative CURTIS. And even with these artificial, I call them artificial, attempts like the interest equalization tax, the cutting back on tourist dollars, and other measures all directed toward the private sector, there was apparently very little directed to correcting the public sector.

In fact we had a bill on the floor of the House a couple of weeks ago in which I thought a positive statement was made that private capital investment abroad affected the adverse balance of payments but public investment abroad didn't.

Nonetheless, the point is that the gold flow is a symptom of a fundamental disease which is the continued deficits in our international balance of payments. Essentially there has been an accumulation of dollars which, of course, can be converted to gold as long as we try to maintain the standard.

Now, one other thing. I was interested in your remarks on the tax cut and its impact. I think it is very important to see in what context this tax cut was made, because the real issue as it developed in the Congress was whether the tax cut would be in the context of expenditure control or whether it was going to follow Dr. Heller's theory of

not cutting expenditures but to have total purchasing power expanded through the tax cut and more spending.

It actually was done in the context of expenditure control, was it not? The $97 billion figure that was in the Republican motion to recommit for the fiscal year 1964 and the $98 billion for fiscal 1965 actually was adhered to as the performance has indicated.

Mr. MARTIN. I think President Johnson has done quite an excellent job in keeping expenditures down.

Representative CURTIS. Certainly it follows this economic theory, which I think is the theory that you too advanced, but the thing that disturbs me is that the President's Economic Report and other statements cause businessmen, among others, to think that this tax cut followed the theory of Dr. Heller which was not in the context of expenditure reform.

Mr. MARTIN. Well, I favored the tax reduction. I think we have been living with wartime taxation for a long time and that we ought to give the economy an opportunity to show what it could do with these added resources.

The purpose of the tax reduction as I see it was to encourage the economy in such a way that we could attain a balance in our accounts and perhaps reach a surplus at the earliest possible date.

Representative CURTIS. That is the way I felt, too. I used a figure of speech that this was removing an impediment to economic growth, not the figure of speech used by those who said it was a stimulus.

There is a difference between removing a rock from your shoe, that in removing an impediment, because you feel pretty good afterward, and from getting a shot in the arm. When the shot in the arm wears off, you don't feel so good.

I think that this becomes quite basic and it is important for us to review the tax cut to see what was done in this area. If the Heller theory had prevailed and our expenditures had been around $105 billion instead of $97 billion, as they might well have been under the projections of the budget, I think we would have had inflationary forces breaking loose in our economy that would have been hard for you and the Federal Reserve or anyone to contain.

What would have happened if we had had an expenditure level of, say, of $103 billion on something like that?

Mr. MARTIN. It certainly would have put us under more pressure. As I point out in this statement the tax reduction as it worked out has been extremely well handled by the people getting it.

I think it was questionable in the early part of the year when I was up here last year, I had some apprehension about what the unleashing of this amount would do to the economy but the people who got the tax reduction handled it surprisingly well and the economy moved along quite effectively.

Representative CURTIS. One thing, we delayed it by a year, until 1964, which was a beneficial thing. The administration following its economic theory wanted it in 1963.

My own judgment is that there was still too much expenditure. I felt, and still do feel, that if we had cut to $95 billion we probably would have provided a much more sustainable economic course of growth.

Now, I won't have time to develop this in this round, but I am deeply concerned about the impact of debt management policies and

problems on our monetary policy. It seems to me that the two are so closely interwoven that at times the debt management problems shackle our monetary authorities and, I would add one other thing, that at times they supersede.

I am intrigued with the manner in which high interest rates were encouraged, if that is what it was, in short-term money through the debt management policy of higher interest rate notes which was posed as a deliberate policy. I want to commend the debt management authorities for the policy of holding down interest rates, bonds, and long-term issues. Evidently this did accomplish the result in the overall economy but, if so, this was essentially debt management policy that produced these results and rather than monetary policy.

Now if I am in error on that, please comment on it to illustrate how this did mix.

Mr. MARTIN. Yes; I think, Mr. Curtis, that debt management and monetary policy have been complementary. Neither one nor the other has been the controlling factor in this. We have had a mutually complementary policy. I believe we would have had to have a more restrictive monetary policy than we had if the Treasury had not agreed completely with us on the desirability of the ends we were achieving and their policy was always complementary to ours and ours to theirs.

I don't think that either one has been superseding the other.

Representative CURTIS. In other words, and my time is up, what you are saying is that you don't feel that the problems of debt management, and the solution of them, interfered with what otherwise would have been the policies that you would have liked to have followed in the monetary area.

Mr. MARTIN. Not at all. We have had a strictly complementary debt management and monetary policy all through the year.

Representative CURTIS. So it has been—so maybe the deficits have been helpful to you, the fact that there has been the additional amount of Government bonds we have tried to monitor.

Mr. MARTIN. They have issued securities in accord with what we agreed between us would be good debt management and monetary policy.

Representative CURTIS. I am wondering whether we had more to market than was desirable from the standpoint of adhering to good monetary policy?

Mr. MARTIN. That is a budgetary problem, you see. That gets back to your judgment as to whether we would not have been better off with a lower rate of spending.

Representative CURTIS. Exactly, but it is the issue, you see, and I am encroaching on other's time, but I will finish the thought. This is the point I was trying to draw here. Through the deficits we have been increasing marketable debt. I think this has actually interfered with what otherwise would have been a more desirable monetary policy. We will leave it there for further answer because I have encroached on other's time.

Chairman PATMAN. Senator Douglas, sir?

Senator DOUGLAS. Mr. Martin, I am getting a considerable volume of mail from bankers and other financial groups demanding that Congress defend the independence of the Federal Reserve Board. And in

the body of these letters the assumption is evidently made that by the Constitution and by the legislation setting up and defining the powers of the Federal Reserve Board under the Federal Reserve Act that it is intended to give autonomy to the Federal Reserve Board to make all these decisions, they are to be independent not only of, the executive, but of Congress. Do you agree with this position?

Mr. MARTIN. No, I don't. I think we are a creature of the Congress.

Senator DOUGLAS. May I quote you then to the financial circles?

Mr. MARTIN. You may quote me to all the people who are writing you.

Senator DOUGLAS. This is because of section 8 of the Constitution which gives the Congress the power to coin money, regulate the value thereof.

Mr. MARTIN. That is right. I recognize that, Senator.

Senator DOUGLAS. And this applies not merely to metallic coins but to note issue.

Mr. MARTIN. That is right.

Senator DOUGLAS. Not only to note issue but to demand deposits.

Mr. MARTIN. That is right.

Senator DOUGLAS. You are acquainted undoubtedly with section 10 of the Federal Reserve Act, the second subsection, which gives to the President the power to remove a member of the Federal Reserve Board for cause.

Mr. MARTIN. Well, I have not given any consideration to that.

Chairman PATMAN. Would you yield briefly, Senator?

Now he pursued the B part but the A part, I think, is still hanging up in the air.

Senator DOUGLAS. May I put it this way? Could not Congress delegate some of its power of supervision over the Federal Reserve Board to the executive?

Mr. MARTIN. It certainly could. The Congress can change the Federal Reserve Act any time it wants.

Senator DOUGLAS. This would not interfere with your independence. It would merely provide the supervision of the exercise of that power to another body other than the Congress, isn't that true? If Congress has this power it can delegate the power. We delegated the power over the money supply to you.

Mr. MARTIN. Congress can do anything it wants. I have no question on that.

Senator DOUGLAS. I yield for a minute to the chairman.

Chairman PATMAN. I want to ask you this: If there is a conflict in views, honest opinions, of course, between the Chairman of the Board of Governors and the President of the United States, which ones would prevail under present policies and practices?

Mr. MARTIN. Well, as the law now stands I would think that the Federal Reserve Board has the authority to act independently of the President.

Chairman PATMAN. Despite the President?

Mr. MARTIN. Despite the President.

Chairman PATMAN. That is right. I knew that was your opinion. I just wanted to verify it.

Mr. MARTIN. I say any time the Congress can change that. They can make us part of the executive branch and they can put us out of business. They can do anything. You have complete control.

Senator DOUGLAS. Mr. Martin, one difficulty that we find in the raising of bank rates by the national banking authorities is that it can result in a competitive situation with other central banks and bank authorities who raise their rates. During the last year I think it is true that nine central banking authorities out of the so-called group of 10, and Switzerland, have raised their rates. Now if we raise our rates in order to hold short-term deposits in this country and this stimulates the other central banks to raise their rates are we any better off then?

And may there not be a competitive situation which is launched with each of the central banks raising rates and no country improving really its position but in all countries the policy having a repressive effect or influence upon production and employment?

Mr. MARTIN. Well, it is assumed that each country is trying to make its decision in terms of its interest. But at the same time since we have had convertibility of currencies this has been a problem. That is why the OECD and the central bankers, at their meetings, have constantly been discussing this problem so as to avoid competitive rate movements of this type.

Senator DOUGLAS. What did you think of these movements last year? Were they not competitive movements?

Mr. MARTIN. No, I don't think they were competitive. I think they were taken largely due to the international decisions of the country where they had an inflationary situation that warranted higher interest rates.

Senator DOUGLAS. Britain was forced to raise rates from 5 to 7 percent. I think you raised your rates one and a half percent. Suppose the central banks raised their rates again?

Mr. MARTIN. Rates are not the only thing that will solve the balance of payments but holding down the outflow of funds seeking higher returns certainly is one of the factors of this. This is one of the problems, Senator.

Senator DOUGLAS. Do you see any answer to the problem?

Mr. MARTIN. I see an answer to it in the sense that we cannot have very disparate interest rates around the countries of the world today for any great length of time since we have convertible currencies. We can no more be an isolationist on interest rates than we can be on foreign policy.

Senator DOUGLAS. Does not this give the power to a country which wants to raise interest rates to force interest rates in all other countries to go up?

Mr. MARTIN. No, I would question whether it does. It certainly tends in that direction; yes, if they are doing it for arbitrary reasons.

Senator DOUGLAS. Well, the central banks will consider political issues as well as economic issues, will they not?

Mr. MARTIN. I am afraid they consider political issues too much. I think that is one of the troubles in the world today. We are having too much politics in money.

Senator DOUGLAS. But you don't think raising interest rates is dictated by political reasons?

Mr. MARTIN. I think that primarily it has not been. I say there has been a tendency in some countries to get too much politics into money policy.

Senator DOUGLAS. I wonder if you could develop that a bit?

Mr. MARTIN. For example, I don't think it is a very fine posture for the United Kingdom to be in when their foreign Secretary comes over here and after leaving the White House says that at no time will they raise the bank rate and then 2 weeks later they put it up 2 percentage points.

I think it would have been wiser—I am not trying to criticize him as an individual—I think it would have been wiser if they had not made that sort of statement.

It was made it seems to me in a political framework, not in an economic framework at the time.

Senator DOUGLAS. You have no criticism of the French banking authorities?

Mr. MARTIN. I would criticize them if they did the same thing.

Senator DOUGLAS. Do you think the French banking authorities have been under the control of General de Gaulle and have called on us to redeem claims which they had against us in gold?

Mr. MARTIN. I can't really speak for the motives of the French.

Senator DOUGLAS. Have they done so?

Mr. MARTIN. They are taking gold from us, yes. At the present time, they have a right to.

Senator DOUGLAS. There is a statement that French purchases of gold in January and February amount to more than $200 million. The further statement is that France will buy $90 million more in February and undisclosed amounts in addition. France has said she will convert all additional dollar acquisitions into gold.

This would be $500 million if not changed and the total figure for the year would therefore be well over $600 million. It might run to $700 million. Now these requests come from the Bank of France, do they not, not merely from the French Treasury?

Mr. MARTIN. That is right.

Senator DOUGLAS. Then do you think that the Bank of France is operating under the political theories of General de Gaulle?

Mr. MARTIN. They have stated what their position is, they intend to take whatever additions they get to their balance of payments.

Senator DOUGLAS. That is a political decision which General de Gaulle has made and which the Bank of France is following out. Why don't you condemn the Bank of France as well as the Foreign Secretary in the Labor government?

Mr. MARTIN. I do condemn them. If they don't have confidence in the dollar I hope that we can convince them they are wrong. We have a commitment here to convert their dollars into gold. Our President has made a solemn statement that the dollar is as good as gold at $35 an ounce.

Senator DOUGLAS. Mr. Martin, the International Monetary System consists of $40 billion of gold and $25 billion of foreign exchange which are nearly all claims against the dollar. If De Gaulle continues his policies and if the policies are followed by other countries you will have a shrinkage in the total volume of the international monetary medium because the dollar claims will be called for in gold and you will have a shrinkage of the total medium as well as a redistribution of the gold.

Now would not that be a highly unfortunate situation to develop? Would it not cause a fall in the world price level and in all probability an increase in unemployment?

Mr. MARTIN. If we don't get our balance of payments in order and the British don't get their balance of payments in order, if we don't have better balance, all of us will have a shrinkage——

Senator DOUGLAS. Do you think there is any obligation upon countries which hold dollars not to call for these dollars in gold when to do so would create a possible international depression?

Mr. MARTIN. I think that they should be responsible in this. I think having a right to use gold as a medium of exchange carries with it some responsibility but I also think there is a responsibility on our part to correct our balance of payments.

Senator DOUGLAS. Do you think they are being responsible?

Mr. MARTIN. I think most of them are, yes.

Senator DOUGLAS. Do you think the Bank of France is being responsible?

Mr. MARTIN. I can't speak for the Bank of France.

Senator DOUGLAS. Do you think the total French policy is responsible?

Mr. MARTIN. I don't like the French policy.

I am not here to defend the French policy. I don't like it at all. As I did when you and I had this same colloquy in the Senate Banking and Currency Committee, I respectfully say I am not in the diplomatic arena. I am doing the best I can in the financial area.

Senator DOUGLAS. Yes, but we want to get advice from you, Mr. Martin.

Mr. MARTIN. I am giving you the best I have.

Senator DOUGLAS. Do you think that if this policy of France continues and is extended that there is danger the International Monetary System will break down?

Mr. MARTIN. I do, indeed.

Senator DOUGLAS. And we might have a world depression?

Mr. MARTIN. I think there is a real danger that unless we correct our balance of payments and the British correct their balance of payments and we get into better balance, we will have.

Senator DOUGLAS. You imply that we are the sinners in this matter. Do you really believe that?

Mr. MARTIN. I really and truly believe that we have no excuse for running the balance-of-payments deficit that we are currently running.

Senator DOUGLAS. If you analyze the items in the so-called unfavorable balance of payments you will find they consist first of military expenditures and foreign aid and, second, export of private capital abroad.

Now there is a favorable balance of trade of many billions. Now how are we going to reduce those two items and if we were to do so how could the currency, the world currency, expand to meet the requirements of expanded trade?

Our deficits really finance the increase in the world trade.

Mr. MARTIN. I would like to see us get out from behind the eight ball as I said the other day when we were having this colloquy and lend this money to our foreign friends instead of being in a position where they can at their initiative put us on the defensive. We could supply these reserves that you are talking about as a reserve currency as well by proffering assistance, as we did through the Marshall plan in the early days after the end of the war, just as readily as we can by running an automatic deficit.

Senator DOUGLAS. My time is up.

Chairman PATMAN. Senator Jordan.

Senator JORDAN. Mr. Chairman, developing this capital outflow matter a little further, in 1964 our capital outflow exceeded the 1963 outflow by $2 billion, you said?

Mr. MARTIN. That is right.

Senator JORDAN. You said further that we are relying heavily on voluntary cooperation by banks and other financial institutions and nonfinancial businesses to cooperate in reducing this outflow of capital?

Mr. MARTIN. That is right.

Senator JORDAN. Now I have here an article by Russell Bonner from the February 24 Wall Street Journal in which he suggests that it is not likely that we are going to get much voluntary compliance with this request. It is quite a lengthy article. No doubt you have seen it. I quote just one paragraph from it. Allan K. Jackson, an official of International Research Consultants, said:

> I don't think it is feasible for any dynamic U.S. company to stop investment abroad. The plea is only good when it makes economic sense and it does not make sense for U.S. manufacturers to let their markets here evaporate.

Would you comment on that and indicate what you would recommend in the event we do not get voluntary compliance? What do we do then?

Mr. MARTIN. We would have to take a look at the whole program again. We would have to look at the military expenditures. We would have to look at foreign aid. We would have to look at credit policy. We would have to look at everything if we failed to do it in this way. I must say that I don't agree with that article on the basis of what has developed to date. We have gotten splendid cooperation in this from both bankers and businessmen.

There are hazards as I point out in my statement here. When you ask people to forgo profits you are asking a good deal of them. But this is a matter of national integrity and anyone thinking about their stockholders in the long run, any large corporation particularly, will realize that this is an emergency situation that we are in, and that we must establish a basis for longrun confidence in our currency.

Senator JORDAN. You would say then in your opinion we are getting substantial voluntary compliance and you expect we will get more?

Mr. MARTIN. It has just started, Senator. We got off to an extremely good start. We had some 90 bankers and representatives of the nonfinancial institutions, and we had the executive vice president of the American Bankers Association. We had virtually all of the heads of the largest banks in the country and I would say that we are off to a good start.

Senator JORDAN. When the pound sterling came under pressure we joined with a number of other industrial nations to provide the $3 billion in hard cash to help defend it. Britain at the same time raised their import duties and interest rates to 7 percent. Now in turn the Federal Reserve Board raised the discount rate from 3½ to 4 percent and time deposits went up to 4½ percent over 90 days.

Tell me, how do you know precisely how much to raise the interest rates? What criteria do you use? If Britain's rate goes up 7 percent and they put on import duties, how do you go about determining what the increase should be in this country?

Mr. MARTIN. In that situation all we can do is feel our way.

Senator JORDAN. By trial and error?

Mr. MARTIN. Yes, we can have a flexible monetary policy. Earlier in 1964 Britain increased its discount rate from 4½ to 5 percent. We did not make any move in ours at the time because we have had underutilization of resources and more unemployment than we wanted.

We have been trying to do everything we can in concert with the administration to stimulate employment and to help the economy. So, we watched the markets very carefully there to see whether there was going to be any additional pressure on us.

We decided we could take that rate.

Senator JORDAN. You say that is about right, in your judgment?

Mr. MARTIN. As it worked out monetary policy has been about right. Now later they went up to 7 percent. At that point we felt that this was going to be too large a differential. If we had let the world think that we were not going to make any effort to protect our currency via interest rates, we would have been just asking for trouble.

We, therefore, made this modest increase and at the same time we kept funds available here to help stimulate the economy.

I think it has worked surprisingly well so far. But if it does not work we may move down or up. It is a flexible operation.

Senator JORDAN. I have one more question, Mr. Chairman.

The Federal Reserve Board has the power, as I understand it, in cases of emergency to waive the 25 percent gold reserve requirement pledged to back up Federal Reserve notes. Is that true?

Mr. MARTIN. That is right; yes, sir.

Senator JORDAN. At what point in a badly deteriorating balance-of-payments situation would you regard it critical enough that you would exercise the authority to waive that?

Mr. MARTIN. We would only do that when we were right out at the margin, you see. Now we have just gotten through the new legislation an additional $5 billion in gold.

Senator JORDAN. Yes; on account of the backup behind the deposits.

Mr. MARTIN. That is right. But we would certainly not waive this until we got down to the 25 percent on the currency. In other words, we would have to lose the $6 billion of gold that we have now before we would be up against using that waiver.

Senator JORDAN. Of course that additional $4 or $5 billion in gold won't really last indefinitely at the present rate of depletion assuming it should continue.

That's only a stopgap measure. Do you think that the permanent remedies which have been proposed will be adequate enough to meet the situation before the breathing space we have permitted with this $4 or $5 billion is exhausted?

Mr. MARTIN. I think it must be. I think we must not falter in this program that we are embarked on now. I think it is a very serious thing for the country.

Senator JORDAN. I am pleased to hear you say that because I think you take it more seriously than many others. I wish more of them did.

Mr. MARTIN. I take it extremely seriously. To me this is the most serious problem this country has faced in a financial way for many, many years.

Senator JORDAN. Thank you, Mr. Chairman.

Chairman PATMAN. Rr. Reuss.

Representative REUSS. I want to sincerely congratulate you, Chairman Martin, on the monetary performance of the Federal Reserve in the last year. Your creation of about a 4-percent addition to the money supply, I think, played a very constructive part in the big improvement we had in our growth rate and in our attack on unemployment.

You say in your statement that in your opinion monetary policy did what it could and should do to facilitate healthy economic growth within the United States. I believe it did play a constructive role.

I hope you take pride in the fact that partially as a result of what the Federal Reserve did, many hundreds of thousands of dropout young people, many hundreds of thousands of Negroes, Puerto Ricans, disadvantaged groups, and other actual and potential unemployed got jobs and contributed to the economy.

This is a very real achievement and I give you full credit for sitting there throughout the year in which you always had in front of you on the shelf next to your desk a bottle entitled "Tight Money," and you never drank from it. You may have taken a couple of sips.

Then you say—

> In our effort to try to do all that we could I only hope that we did not do a little more than we should have.

Well, in the light of what has happened, giving some hope to the jobless, if you did do more than you should have, and I don't think you did, God will forgive you.

In your statement, after making the point that the President's voluntary program for limiting capital outflows abroad is a good one, and after saying that if you don't get cooperation in this it is not going to work, you then have this sentence, and I am quoting:

> If at any point it appears to us that we are not making the gains envisaged in the President's message we must all be prepared to take whatever additional measures are needed. Including, of course—

I am supplying the italics—

> *of course, a less expansive overall credit policy.*

I am detecting a note of retrogression.

Mr. MARTIN. Your detection is correct.

Representative REUSS. Are you not prepared to consider the use of a capital issues committee, some sort of statutory method of controlling our capital outflows, so that the bad guy, the people who have not cooperated with the President, may be brought into line with the good guys, the people who are willing to cooperate.

I don't see any mention of that possibility in your immediate recourse to tight money, but it scares me a bit.

Mr. MARTIN. I say I am prepared to take whatever additional measures are needed. As I indicated to Senator Jordan I think that would mean taking a look at our military expenditures, foreign aid, and our credit policy.

Representative REUSS. I don't find in that enumeration the possible additional measure of doing by law that which lack of cooperation has demonstrated can't be done by voluntary persuasion.

Would you add that to your list of additional measures?

Mr. MARTIN. Yes, that is a possible additional measure. We will have a bill, you know, to facilitate the voluntary credit restraint program.

Representative REUSS. Antitrust?

Mr. MARTIN. Yes, right.

Representative REUSS. But there is nothing in that bill that will compel businessmen or bankers who, for selfish reasons, don't want to cooperate; there is nothing in that bill that requires them to cooperate.

Mr. MARTIN. No, we can't compel people to avoid selfishness. Let me make a comment on monetary policy. I think all experience with selective controls shows that unless they are buttressed by some effective handling of the total reservoir it is very, very difficult to do anything with them.

That has been the experience of everybody in every country. If you just eliminate the general control entirely it almost means going to a police state. That is why you have to have general controls.

Representative REUSS. I hope that if, God forbid, during the year the time comes when additional measures are needed, you will come and talk to your friends on the Joint Economic Committee before you seize on "of course, a less expansive credit policy method."

Mr. MARTIN. I assure you we will talk to the people in the administration at great length. As I said to you before, I don't think it is feasible for us to come down and take you into our confidence on everything.

Representative REUSS. Right after you have sipped from the tight money bottle you will be up here, won't you?

Mr. MARTIN. Right after we take a sip, Mr. Patman will have us up here explaining our action. Let me point out that if we take the sip from the bottle of easy money, Mr. Patman probably won't have a hearing.

Representative REUSS. Turning now to the events of last November 25, prior to your raising of the U.S. discount rate from 3½ to 4 percent, you, of course, were in touch with the responsible British monetary and central banking authorities, were you not?

Mr. MARTIN. I was in touch with the governor of the Bank of England; yes.

Representative REUSS. Did you advise the British that rather than raising their discount rate from 5 to 7 percent, in conjunction with our raising ours from 3½ to 4 percent, they instead raise theirs from 5 to 6½ percent, thus obviating the necessity of our raising our rate?

Mr. MARTIN. I did not advise them at all on what they should do. I listened to what their problem was and what decisions they had arrived at. I pointed out to them that if they moved in this direction that it was very likely that we would move also but I could not in any way guarantee that.

I have a board and I have an open market committee and I could not make any commitment to the governor of the Bank of England as to what we would do.

Representative REUSS. Don't you feel that you are enabled on a friendly basis to point out to your opposite numbers in other countries what varying effects different actions on their part may have on us?

Mr. MARTIN. I have constant discussions with my counterparts whenever I have an opportunity. Here I claim executive privilege on that, as I am sure that if I were to come up to a committee of the Congress and tell them about all the nuances of these talks with monetary officials in other countries, they would not talk with me very long.

Now when it comes to decisions, that is a different matter. But you are asking me now about conversations back and forth between me and my counterpart. I think that is a mistake.

Representative REUSS. I asked you whether you advised the British with respect to restricting their increase from 5 to 6½ percent rather than 7 percent so that we did not have to raise our discount rate from 3½ to 4 percent and your answer is no, you did not give such advice.

Mr. MARTIN. That is right.

Representative REUSS. It is true, is it not, that the foreign central bankers individually and collectively at Besel give us all kinds of advice?

Mr. MARTIN. It is give and take.

We do it through informal talks. We also have the OECD to which Mr. Young, who is with me here, goes as representative of the Board constantly. There it is an open field day.

Representative REUSS. Somehow I always read in the papers, due to the energy of the American press perhaps, the advice that the Foreign Central Bankers give us, which is almost invariably to raise interest rates in America, but I never read what advice we give them.

I just hope that our friends in the press could establish some parity of leakage on that.

Let me go to a new point now—the action of the Open Market Committee way back on February 20, 1961. I won't quote the whole thing, you are familiar with it, in which it said that the open market is now soft-pedaling its former "bills preferably" policy, and is going to buy longer term securities.

I am trying to paraphase it. That is about what it said. Now, Mr. Chairman, I ask that there be admitted into evidence a table I have had prepared showing the maturity distribution of U.S. Government securities, Federal Reserve System portfolio from January 1961 to date.

Chairman PATMAN. Without objection, it is so ordered.

(The information referred to follows:)

Maturity distribution of U.S. Government securities, Federal Reserve System portfolio, last Wednesday in January—1961–65

[Dollar amounts in millions]

	Jan. 25, 1961	Jan. 31, 1962	Jan. 30, 1963	Jan. 29, 1964	Jan. 27, 1965	Change, 1961–65
Within 15 days	$573	$5,500	$511	$331	$1,423	$850
16 to 90 days	4,938	1,408	5,021	5,944	3,233	−1,705
91 days to 1 year	9,113	10,380	11,756	15,422	16,469	7,356
Over 1 to 5 years	10,673	8,751	10,773	8,669	13,506	2,833
Over 5 to 10 years	1,179	2,227	2,094	2,136	1,797	618
Over 10 years	271	266	151	219	295	24
Total	26,747	28,532	30,306	32,721	36,723	9,976
	Percent of total					
Within 15 days	2.1	19.3	1.7	1.0	3.9	
16 to 90 days	18.5	4.9	16.6	18.2	8.8	
91 days to 1 year	34.1	36.4	38.8	47.1	44.8	
Over 1 to 5 years	39.9	30.7	35.5	26.5	36.8	
Over 5 to 10 years	4.4	7.8	6.9	6.5	4.9	
Over 10 years	1.0	.9	.5	.7	.8	
Total	100.0	100.0	100.0	100.0	100.0	

Source: Federal Reserve Bulletins.

Senator DOUGLAS. Will you state what it shows?

Representative REUSS. One of the interesting things that it shows is that over the last 4 years, from January 25, 1961, to the present, the total Federal Reserve portfolio has increased by $9,976 million, close to $10 billion; that U.S. Government securities from 91 days to 1 year have increased by $7,356 million, or almost three-fourths of the total; but that the holdings of securities of over 5 years have increased by only $642 million, or a tiny fraction, less than 10 percent, of the total.

Now, would it not have been a useful thing, and is it not still a useful thing, if the Fed would purchase a larger number, percentagewise at least, of securities of over 5 years? Would this not have a healthy effect on the domestic economy and particularly wouldn't it help to postpone the evil day, which you have mentioned this morning, when you are going to be in here recommending the removal of the 4¼ percent limitation on the interest rate on long-term Federal securities?

Mr. MARTIN. No; I don't think so, Mr. Reuss. I think the amounts, the time, and the way you purchase securities is always a question of judgment. We gave up bills preferably as a policy, as you say, in 1961, and we have felt no inhibition in operating in any sector of the market but our operations have been conducted in terms of where we thought we would get the best price and have the most effect in carrying out our current policy. This is not a market that is always just like a bid and ask market on the stock exchange where there are plenty of securities available.

It just is not that sort of market. In the longer end of the market, sometimes it depends entirely on whether you can find any securities offered without bidding up the price so that you put everything else out of relationship.

I don't mean that it has been perfect by any means, but I think our record of dealing in all the maturities in the Government securities market has been extremely good since that time.

Representative REUSS. My time is up, but I do want to express again my disappointment that, since this great resolve of the Fed back in 1961, the holdings of maturities of over 1 year has actually declined from 45.3 percent of the total to 42.5 percent of the total.

If my figures are wrong, I would appreciate being corrected; but that seems to me an unhappy record.

Mr. MARTIN. Mr. Young points out to me that those figures are not a record of our purchases because they don't allow for the passage of time.

Mr. YOUNG. The shift from one category to another of securities in our portfolio.

Representative REUSS. This refers to the holdings?

Mr. YOUNG. Yes; not to purchases.

Chairman PATMAN. Would you like to insert a table, Mr. Martin, in connection with this?

Mr. MARTIN. Yes; I will be very glad to.

Chairman PATMAN. Without objection it is so ordered.

(The material referred to follows:)

Open Market operations

A. NET SYSTEM TRANSACTIONS [1]

[In millions of dollars]

Year	Total	Bills	Coupon issues				
			Due within 1 year	1 to 5 years	5 to 10 years	Over 10 years	Total coupon
1961	3,048	1,308	−874	1,826	660	128	1,740
1962	3,108	602	683	1,461	326	37	2,507
1963	4,256	2,851	2	793	543	68	1,406
1964	5,018	3,996	5	465	440	111	1,021

[1] Minus (−) indicates net sales.

B. YEARLY CHANGES IN SYSTEM PORTFOLIOS [1]

[In millions of dollars]

Year	Total	Bills	Coupon issues				RP's
			Due within 1 year	1 to 5 years	5 to 10 years	Over 10 years	
1961	1,497	293	2,343	−1,942	1,049	−5	−241
1962	1,939	−741	686	2,070	−133	−116	183
1963	2,773	1,699	3,434	−2,139	44	68	−331
1964	3,451	1,903	−3,553	4,837	−339	76	526

[1] Data differ from those in table A, because they include the effects of the passage of time and of System participation in Treasury financings.

Chairman PATMAN. Mr. Ellsworth.

Representative ELLSWORTH. Thank you, Mr. Chairman. Mr. Martin, I would like to compliment you for your fine testimony this morning. I would like to take a few minutes to clarify in my own mind some of the testimony we have had this week on the use of credit—monetary policy—in connection with this international balance-of-payments problem.

Some people have said that the issue is whether or not monetary policy can have an immediate and direct effect on the balance-of-payments situation. Some say we should use it for that purpose and others say it is ineffective for that purpose. Then yesterday Professor Saulnier was here saying that he felt that monetary policy had a role to play in connection with this overall balance-of-payments problem but not so much in its direct immediate effect on the balance as in its long-term effect in maintaining confidence in the willingness and ability of the United States to pay $35 an ounce for gold, thereby maintaining the overall stability of the international monetary system.

Now against that background I want to invite your attention to the fact that it was stated in the 1963 economic report from the Council of Economic Advisers, that more forceful use of tax policy in support of economic expansion would give greater freedom to using monetary policy to strengthen our balance-of-payments position. I would like to ask you if monetary policy has in fact been used more vigorously

in correcting balance-of-payments position since enactment of the tax cut in 1964?

Mr. MARTIN. To a certain extent, yes. We have had a very difficult time assessing, as I indicated in this statement, what the impact of the tax reduction has been in terms of the economy.

As I indicated in one little talk I made in May, a year ago, I was completely wrong in my judgment earlier in the year. I thought that the tax reduction was going to cause a real upsurge in the domestic economy that would complicate both our international problem and our domestic problem, but it didn't develop in that way.

As a matter of fact, a lot of the tax reduction went to individuals, and they saved the money instead of spending it at that particular time. But in August of last year we began to worry about the overall thing and we did move to a slightly less easy monetary policy.

We have kept flexible on it ever since.

Representative ELLSWORTH. Would you say then, as it has worked out, that we have not had greater freedom since the tax cut for the use of monetary policy in connection with dealing with this balance-of-payments problem?

Mr. MARTIN. In my judgment we have, because our economy has progressed a great deal and we have not been under the same pressure to stimulate the economy that we were before the tax reduction.

Whether you call it a stimulus or an impediment, as Mr. Curtis did earlier, this was a major factor. The impediment was removed or the stimulant was injected.

Representative ELLSWORTH. You said in your statement this morning, and I quote:

> That it is now clear that monetary policy did not prevent a large increase in capital outflows from the United States in 1964.

Mr. MARTIN. That is one of the things which has disturbed me and has made me wonder a little bit, as I did here, whether we did not have too much in the way of dormant pools of credit, some of which were used to send money abroad that would not have gone abroad otherwise.

But this is in retrospect. At the time we were making the judgment we didn't think it was going to work out quite that way.

But this is one of the things that concerns us very much. We should have been more active on this program all along the line.

Representative ELLSWORTH. On using monetary policy you mean?

Mr. MARTIN. Including monetary policy. My feeling on this is that the balance-of-payments problem has gotten so large here that there is no one instrument alone that could solve it today.

Representative ELLSWORTH. Do you look forward to more vigorous use of monetary policy in the months ahead?

Mr. MARTIN. If called for, yes. That is the judgment, you see.

Representative ELLSWORTH. Would you like to comment just generally on Professor Saulnier's statement that he felt that the main value and use of monetary policy in the context of this problem was—well, he didn't put it exactly in terms of positive use of monetary policy, but he said he felt we ought to be alert to keep from increasing credit very much more, in order to maintain confidence in the willingness and ability of the United States to pay $35 an ounce for gold.

Would you like to comment on that?

Mr. MARTIN. I haven't read his statement but I saw what was in the paper on it this morning. This is a matter of judgment and we certainly are going to be alert to conditions as they may develop.

I have made every effort to keep the President and his Council of Economic Advisers and others aware of the problem that is created here. I will continue to do so.

If I may digress a minute, I don't think we can completely separate the domestic and the international. We have been talking about this dilemma for a long time. I have repeatedly testified up here that I think the two at certain points merge.

Senator Douglas, you pointed out my comment on the deterioration in the quality of credit. That has disturbed me. I did not mean to inject the name of a bank into it. But this is the sort of thing that causes trouble.

It certainly is not an indication that credit has been too tight, in my judgment.

Representative ELLSWORTH. Now, Mr. Martin, leaving that subject and just going back to the specific thing you talked about and which has interested me a lot, and that is this move of the British back in November, increasing their bank rate from 5 to 7 percent.

Isn't it a fact that that had no noticeable effect at all on the run on the pound sterling at that time?

Mr. MARTIN. I wouldn't say it had no effect at all, Mr. Ellsworth. Actually they were having a real hemorrhage in the balance of payments at that time and they did stop it. This was an important effect and I doubt very much whether they would have been able to muster the $3 billion pool of credit if they had not made that move. The two went together.

Representative ELLSWORTH. Isn't it a fact that the bank rate was increased from 5 to 7 percent on Monday, November 23, and that instead of stopping the run on the pound sterling it continued and maybe even increased the next day, and that it was only after that, on Tuesday or Wednesday—well on Tuesday in fact—that moves were initiated to generate these new lines of international credit?

Mr. MARTIN. That is right.

Representative ELLSWORTH. As a result of the fact that the bank rate increase had had no noticeable effect.

Mr. MARTIN. I wouldn't say no noticeable effect. It did not have enough effect. The initial impact of the increase in the bank rate was to stem the hemorrhage. In the early stages of Tuesday it looked pretty good. Then on Tuesday afternoon it began to fold again.

At that point the credit arrangements were put in and the two worked together. But the United Kingdom must come to grips with the overall problem.

Representative ELLSWORTH. With the overall problem and this 5- to 7-percent increase was only a gimmick really that had by itself no marked effect on the situation?

Mr. MARTIN. But if it had not occurred it would have been——

Representative ELLSWORTH. I appreciate that and I appreciate what you are saying on that.

Mr. MARTIN. Right.

Representative ELLSWORTH. Would you say that with the situation as it is now, with this $3 billion of credit, and I believe there has been

an extension of that, that neither will that basically and fundamentally correct the problem which Great Britain has? Would you say that?

Mr. MARTIN. I would agree with you on that. They will have to come to grips with the overall problem.

Representative ELLSWORTH. Would you just state what, in your opinion, is the overall problem that they will have to come to grips with so that that can be a complete statement here.

Mr. MARTIN. Competitively they will have to be able to increase their exports in relation to their imports. They put the 15-percent surcharge on their imports. They are now going to reduce it in a few weeks to 10 percent but it has not dcne the job.

Their figures have not been too good since then. They are going to have a budget early in April. That will be watched very carefully by the world as an indication of how seriously they take this problem.

Representative ELLSWORTH. Thank you. My time is up.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Chairman Martin, this is another very skillful and persuasive paper of yours which is certainly characteristic. In your statement you say in discussing commodity price behavior—

> Thus far, the movement in these averages could certainly be described as moderate, and the tendency for more price increases to stick may be related to the high rates of activity in some lines, associated with steel strike anticipations. When this added stimulus is withdrawn or reversed, even the mild uptrend that we have seen recently may disappear.

That is about the only hard specific analysis of prices that I detect in this paper. I would construe from that that you are inclined to feel that there is certainly not a tendency for inflation in commodity prices or in wholesale prices perhaps generally, and that there may be a tendency toward lower prices.

At the same time we have a record of great stability, as you know, in wholesale prices in the last 5 or 6 years and we have a record of very, very limited and modest consumer price increases, the best of any country in the world.

But then you follow up by saying that "I cannot avoid the feeling that we have been and still are sailing very close to the edge in this area." It is a little ambiguous to me. I can't tell which edge it is, inflation or deflation, or maybe we can go either way.

Mr. MARTIN. I think we can, Senator. It is a very delicate and difficult thing. Our staff at the Board is probably evenly divided on the question.

Senator PROXMIRE. I notice that. The positions are very close.

Mr. MARTIN. It is very close. It is a very difficult thing. Now I have felt that there have been tendencies for several months here for prices to break out on the upside. But as I pointed out here one of the reasons for these tendencies is the auto strike and the possibility of a steel strike. But this is typical of the uncertainties that we always have to deal with in monetary policy.

When you are very close to the edge here, if you are going to say that you will never take any action until actually you have had a substantial increase in prices or vice versa, my guess is that you are pretty well out of the game when that occurs.

Senator PROXMIRE. But the evidence that you as an expert would give to the committee suggests that we may be going either way.

Therefore, it would seem at the present time that pursuing the policy we have been pursuing in the past would seem to be quite wise.

Those policies have been expansive. As Mr. Reuss pointed out, we had an increase in the money supply of 4 percent. The figure that you have often used before in this committee would indicate that if we include time deposits the increase has been 8 percent in the last year.

Mr. MARTIN. Right.

Senator PROXMIRE. Which is an enormous increase in time deposits. While I would not be inclined to include them they do have an influence?

Mr. MARTIN. Right.

Senator PROXMIRE. So there has been a reasonably expansive credit policy?

Mr. MARTIN. That is right.

Senator PROXMIRE. Yet we have not had inflation. We have reduced the unemployment rate substantially in the last year. It is still high. But Budget Director Gordon when he appeared before this committee a couple of days ago indicated that in his judgment we don't have to worry too much about inflation until we get the unemployment rate down around 4 percent, 3.8 percent, maybe even 3.5 percent.

Some economists go even farther. Keyserling feels about 2 percent of unemployment is frictional, 1 percent structural, and the rest is lack of demand. At any rate, are you in a position of feeling that when we get in the area of unemployment at about this level, 5 percent or so, we have to be very careful, very likely to be inflationary if we reduce unemployment much more.

Mr. MARTIN. Yes, I belong to that school because I can't believe that we are going to solve the unemployment problem by aggregate demand alone.

Senator PROXMIRE. Yes. A few years ago when you were up here you made a helpful and spirited defense of structural unemployment. At the same time you indicated we may be more concerned with structural unemployment even though unemployment was then 6 percent and perhaps if we reduced it much more it would be inflationary.

I notice Secretary Wirtz and President Johnson have taken pride and indicated they are working hard to train the unskilled, upgrade their skills. As they do this and we make substantial progress certainly the structural unemployment situation will improve, isn't that correct?

We will be in a situation where we can have far less unemployment without inflation.

Mr. MARTIN. Yes, I agree with that. I also think that when you get people going around trying hard to place loans of a semispeculative nature—which is my point under the deterioration of the quality of credit—that where you use credit to pump up aggregate demand unduly you frequently get people to work in jobs that are not going to be satisfactory to them very long or that will not really contribute to their well-being. As soon as there is a little slump in the economy they will be the first people to be let go.

You have to get them to be trained and skilled and educated and acclimated into something that is better than just a temporary job growing out of a credit situation that is just forcing the creation of semispeculative ventures.

Senator PROXMIRE. The whole trend of our economy is in that direction, it is eliminating gradually the job that does not require much skill.

Mr. MARTIN. That is right.

Senator PROXMIRE. And increasing the number of jobs that do require skill and intelligence and pay more?

Mr. MARTIN. That is right. I picked up the New York Times this Sunday. I saw three pages of advertisements, seeking engineers and specialized workers of one sort or another.

Senator PROXMIRE. As time goes on there is more and more of a tendency, and we seem to be approaching it on the basis of this reduction in unemployment, of being able to get unemployment down without having the process for doing so inflationary. Let me just ask you on this last point you referred to.

In your statement you say:

> We may suspect that credit growth in 1964 facilitated unsustainably high rates of activity in some areas and to the buildup of dormant and dangerous pools of liquidity in the economy.

Then you go on to say in the next clause but it is not yet evident that this was the case. Does this mean you have no evidence of this?

Mr. MARTIN. Yes.

Senator PROXMIRE. You suspect but you have no evidence?

Mr. MARTIN. I have scattered evidence of it but nothing on a scale that would convince me we ought to make fundamental changes in credit policy because of it.

Senator PROXMIRE. Is it, No. 1, that we have not had increases in price; there is no evidence on that score? It has been about the same.

Mr. MARTIN. Yes; but let us not get too carried away on these price indexes. I am very proud of the record on prices. Don't misunderstand me on that. There certainly has been a tendency in recent months for price movements to be obscured by finding other means than raising the list price. In other words, I don't think these price indexes are 100-percent accurate.

Senator PROXMIRE. No; but they are the best.

Mr. MARTIN. They are the best we have.

Senator PROXMIRE. And probably the best statistics in the world on price. Also most economists, at least many who have appeared before this committee, have indicated that they may conceal the fact that we have had a quality improvement in much of our service, and so forth, and that has not been reflected.

Mr. MARTIN. That is right, that is another factor.

Senator PROXMIRE. So they may overstate price increases?

Mr. MARTIN. Right.

Senator PROXMIRE. Let me just ask briefly on another line. The problem of international monetary stability, it seems on the basis of your testimony, can best be solved by achieving a balance-of-payments stability on our part.

Mr. MARTIN. Right.

Senator PROXMIRE. You feel that if we can overcome our balance of payments, adverse balance-of-payments situation, that then we can achieve an international monetary stability. Is that right?

Mr. MARTIN. I do indeed.

Senator PROXMIRE. What I am getting at is this. As Senator Douglas implied in his questioning, we have supplied a very large

proportion of international liquidity. If we do achieve stability in our international balance of payments, it would seem that the international effect could very well be deflationary unless you feel that some how it is mandatory that we must loan to other countries all over the world in order to provide the necessary international liquidity that we will have to have for increased world trade and growth of economies all over the world.

Mr. MARTIN. I can just state very briefly my thinking on this. First I don't think there is any problem of international liquidity at the moment.

Senator PROXMIRE. I would agree but in the future?

Mr. MARTIN. For the future I would agree with you. I would only hope that we could work out——

Senator PROXMIRE. We will be reducing the international liquidity at the same time that the need for international liquidity rapidly is increasing with the growth of economies all over the world.

Mr. MARTIN. I think we can take care of that. I have no worry about the gold exchange standard as it presently operates. My principal worry about it is that we are put in the position of not having any initiative in it.

Now, I happen to think that one of the principal benefits to come to the United States out of the Marshall plan—which I conceive to be one of the great achievements of American policy—is the dollar as a reserve currency.

It is an accidental benefit. It has had a prestige factor that I think we are inclined to underestimate. I think this is one of the things that General de Gaulle and his associates resent.

It is a benefit that I think we are entitled to. We are not going to get very much in the way of gratitude from the world, you know. This was a practical and intelligent and proper use of our foreign economic policy.

What has happened is that as a reserve currency we have gradually gotten into a position where for 7 or 8 years they were willing to take all of our dollars automatically.

Then they began to doubt our ability to handle our own affairs in terms of fiscal and monetary balance. You can say that they have no right to doubt it but our short-term liquid assets abroad are only one-quarter of the short-term liquid liabilities that foreigners hold against us.

So we are in the position of having borrowed short and loaned long, exactly the same situation that caused the trouble in the San Francisco Bank, on an international scale.

Now, I would hope some day we could have a better international payments mechanism. But I don't want to see us sitting around the table to work out a new international payments mechanism simply because people no longer have confidence in the dollar.

Because confidence is the basis of all money and credit, we have to set up that payments mechanism, whatever it may be, from strength, not from weakness. We are dealing today from weakness, even though we are the most productive and efficient economy in the world.

But the fact still remains that we are not managing our affairs in such a way that we can really maintain this position. This is the thing we have to deal with.

I consider it a very, very important matter. I suppose I am putting it in the perspective of a banker now but I really think that for the longer run that this is a more important problem, more serious problem, than the other problems that the President was confronted with at the start of his administration.

I think the President recognizes it. I am in strong support of the President on this. I think he recognizes it. I think he wants to see everything done to correct this that can be done.

There are many ways of doing it and there are many facets to it as we all know. But I don't think this is a problem we can just sweep under the rug.

Senator PROXMIRE. Thank you very much. My time is up.

Chairman PATMAN. Senator Talmadge.

Senator TALMADGE. Mr. Martin, it is a pleasure for me to join my colleagues in welcoming you to our committee. I have found your discussion here and particularly the colloquy with members of this committee very helpful and enlightening and informative.

I agree with you that this dollar deficit problem that confronts us is one of the most serious problems that faces our country at the present time. Simply stated I believe that means that we have been spending money overseas faster than it has been coming back to us. Is that about the size of it?

Mr. MARTIN. That is right.

Senator TALMADGE. In the category of the deficit area particularly, that breaks down in loans and investment, military commitments, foreign aid, and tourist travel, about in that order.

Mr. MARTIN. Right.

Senator TALMADGE. That deficit has been continued and constant with rare exceptions for a period of about 15 years as I understand it.

Mr. MARTIN. That is right.

Senator TALMADGE. Beginning in 1957 some of the foreign countries ceased to have as much confidence in the dollar as they had prior to that time and started calling on us for gold at about that year, did they not?

Mr. MARTIN. That is right.

Senator TALMADGE. That has been continued and constant since that time.

Now the Congress has taken some action last year to place a tax on bonds, foreign bonds, and stocks, and loans to try to slow that down. I believe it succeeded to some slight degree, did it not?

Mr. MARTIN. That is right.

Senator TALMADGE. The President I think just this year invoked a Gore amendment that the Congress passed placing the tax also on bank loans, as I understand it, in excess of 1 year in duration.

Mr. MARTIN. Right.

Senator TALMADGE. What effect do you think that is going to have, if any?

Mr. MARTIN. I think it will have a modest effect, Senator, but I think it has got to be not just loans of 1 year and beyond. I think it has to apply to lending generally.

That is why we have this voluntary program.

Senator TALMADGE. What is to prevent a bank from making loans 9 months instead of a year and renewing it over from time to time as the occasion may require?

Mr. MARTIN. Nothing whatever except that they won't be complying with the voluntary credit restraint program.

Senator TALMADGE. I have had some experience in making such loans myself when I was unable to pay them in their entirety when they came due.

Now this capital outflow that you spoke of, in your statement particularly, which has been increasing substantially year after year; is that largely loans to foreigners or is it loans to American corporations for investment overseas?

Mr. MARTIN. It is largely loans to foreigners.

Mr. YOUNG. There are both.

Senator TALMADGE. It is a combination of the two?

Mr. MARTIN. It is a combination of the two; yes.

Senator TALMADGE. Don't you think that the real problem which confronts the Congress and the country at the present time is that since the conclusion of World War II we have acted pretty much as policemen for the world and banker for the world and sometimes Santa Claus for the world and that we are going to have to cut down our commitments in a number of those categories?

Mr. MARTIN. I agree with that, Senator.

Senator TALMADGE. Don't you think we have placed a heavier burden on the dollar than we have been able to carry?

Mr. MARTIN. I think the figures speak for themselves on that.

Senator TALMADGE. For instance, we speak of foreign aid this year, something on the order of $3½ billion. The figures show it is almost $7 billion when you include not only the appropriations for mutual security but the food for peace and our commitments to various international lending organizations. Is that not correct?

Mr. MARTIN. That is correct.

Senator TALMADGE. Is it not also true that we have treaty alliances to protect some 40-odd countries in the world?

Mr. MARTIN. Right.

Senator TALMADGE. Is it not also true that we have troops stationed now in some 30-odd nations in the world?

Mr. MARTIN. Right.

Senator TALMADGE. Including some five divisions in West Germany, and we are getting little assistance in carrying that military obligation from the rest of the world.

Mr. MARTIN. We are carrying, in my judgment, far too large a burden.

Senator TALMADGE. Don't you think it is high time that we call on our allies and other free nations of the world to come in and carry their fair share of the burden and reduce some of our own burdens in that category?

Mr. MARTIN. I do, indeed, but I don't think it is for me to say how that is done.

Senator TALMADGE. I am not asking you as a military authority, but we must lighten our burdens in the categories I have mentioned.

Mr. MARTIN. I agree with you completely.

Senator TALMADGE. Now, let me ask you another question. We have removed the gold cover now on bank deposits, and it was absolutely necessary to prevent a run on the bank for our gold. Now, assuming this dollar deficit problem is not corrected, the next step that would

have to be taken, I assume, would be remove the gold cover on Treasury notes. Would that not be true?

Mr. MARTIN. Not Treasury notes, on Federal Reserve notes in circulation.

Senator TALMADGE. Notes in circulation?

Mr. MARTIN. That is right.

Senator TALMADGE. Suppose we remove those by force of necessity because we had not corrected the dollar deficit and assume they got all of the gold that we had in Fort Knox. What would then happen to the dollar?

Mr. MARTIN. We would be in the position where we would have to live within our international income. We could not have anybody going abroad or doing anything we wanted to abroad unless we could have an offsetting export.

Senator TALMADGE. What do you anticipate would happen to the dollar if we lost all the gold that we had in Fort Knox and would be unable to redeem any of it in gold?

Mr. MARTIN. We would have devaluation of the dollar.

Senator TALMADGE. To what degree? Is it possible today?

Mr. MARTIN. I don't think you could spell out what degree.

Senator TALMADGE. That would be calamitous internationally and domestically.

Mr. MARTIN. And domestically, in my judgment.

Senator TALMADGE. Now to turn to another point, I think you stated that it was impossible to foretell at the present time whether we might have inflation or recession in the foreseeable future. Is that your present conclusion?

Mr. MARTIN. That is right.

Senator TALMADGE. It could go either way?

Mr. MARTIN. It could go either way.

Senator TALMADGE. And the signs are such that it is impossible to to predict with any accuracy in the foreseeable future.

There is another thing I would like you to comment on. Of course, one of the great things about our economy at the present time is that we have a most favorable balance of trade.

I think that was about $3.6 billion last year. Is that correct?

Mr. MARTIN. Our commercial surplus.

Senator TALMADGE. Now the signs I see in the European Economic Community are somewhat disturbing. They have already taken some action against American farm commodities and the future is not bright on other farm commodities. Yet we export to the European Economic Community about $1.2 billion worth of American agricultural commodities, and that is all for dollars, as I understand it.

Mr. MARTIN. That is right.

Senator TALMADGE. If the common market countries continue their present protectionist policy, is it within the realm of possibility we might lose virtually all that export of $1,200 million?

Mr. MARTIN. We would certainly lose a large part of it.

Senator TALMADGE. That would further add to our problems on the dollar deficit, would it not?

Mr. MARTIN. It would, indeed.

Senator TALMADGE. Mr. Martin, thank you, sir. Those are all the questions I have.

Chairman PATMAN. Thank you, sir. Mr. Martin, you brought out in very few words this morning something which has been talked about a long time concerning who is really the boss, the Federal Reserve Board or the President of the United States.

You, of course, stated that in the case of conflict you feel that the Federal Reserve Board should prevail. Of course, we agree we have a great Constitution, and the Constitution says that we have, of course, in words either implied or expressed, without using the exact words, that we have a democracy and we have a Republic.

I believe President Madison was right when he said that the correct definition of our form of government is a democracy in a Republic. In other words, we have a form of government where the people are in control.

They made it so in the Constitution. The House is elected every 2 years. If the people are dissatisfied they can change the entire trend in Government by changing the entire House of Representatives every 2 years if they want to.

It is a wonderful thing. I hope it is never changed. The President is elected every 4 years. Then the Senators are elected for 6 years, one-third of them every 2 years. I think it is a very fine balance. Of course, the Supreme Court is a lifetime term.

Now, then, in your case, I believe that you are asserting a position that is impossible to maintain in our form of government.

Now, you are within your rights in advocating the Constitution being changed to where you would have an autocracy of money or dictatorship of money or money trust. You would be within your rights in advocating that. But when you state that you have the power to usurp that authority under our present Constitution, I think you are just way off in view of the fact that article 1 of the Constitution gives Congress the power to make all the laws. And then article 2 gives the President the power to carry them out.

It says that the Executive power shall be vested in the President of the United States of America. That means, of course, that he executes all the laws. The Federal Reserve Act is a law just like any other law. I know you have often said that your interpretation was that you have been given an indenture by Congress but you won't find the word "indenture" in this or you won't find any implications or suggestions that it is intended.

It is just a law, that is all, the Federal Reserve Act passed by Congress, approved by the President, just a law. The Constitution says that all Executive powers are in the President. That means that he would enforce that law. Of course, the people in having adopted this Constitution presuppose that anybody dealing with their affairs in the legislative or executive branches, that they would in some way be able to come back at them.

In other words, for good service they could be rewarded by reelection. For bad service they could be defeated for office. Now you place yourself outside of that category. You are in a 14-year term. You can't be reappointed. There is nobody who can hold you to blame, nobody who can vote against you or for you.

You can defy the President of the United States and go ahead and do what you want according to the interpretation that you have given this thing. And you are not responsible to the people or anybody who is elected by the people.

You are on your own, and I think that is contrary to our form of government, entirely contrary, and I don't believe you can sustain it very long. I know that you have sustained it so far, but you are on pretty thin ice, Mr. Martin, you are on pretty thin ice. Now we have gone to the grassroots on this thing and we have sent out over 300,000 speeches, by request of people wanting them. There is tremendous interest in them among students, young people, teachers especially.

I find three categories of people: One category wants the central bank to be independent; that word "independent" to me means that you are defying the President of the United States.

Just like a rabbit in a briar patch, he has a home there, he is happy. A lot of them want you to be independent. Of course, most of them are bankers. Of course, they have a selfish reason for this. They want it just like it is. The second category wants to do what some of us want to do. We want to clip your wings. We want to fix it so——

Representative CURTIS. You are not a rabbit anymore.

Chairman PATMAN. We want to fix it so that you won't have any money trust or autocracy. We want it so that Members of Congress when they are elected, and through them, the people can express themselves on the question. As it is now they have no power to. A Member of Congress running for reelection will say, "Why, the Federal Reserve has charge of that." That is what you have been telling them to say all the time.

The executive branch of the Government is headed by the President, of course. When the President runs, and when they criticize him on monetary policy, he has to say, "Oh, the Federal Reserve is running that." So the people have no direct approach to this problem, and something has to be done.

Now, the third group is made up of people who don't know too much about this subject. Therefore, a Member of Congress can safely vote against any change insofar as they are concerned. There is not a Member of Congress including myself or any other who can't be called up over the long-distance telephone while the rollcall is going on and told how the bankers want him to vote—and we will answer it because they are prominent bankers, good people, and we want to cater to our good constituents—and when they say "Vote against that bill, it is unorthodox, it will hurt the bankers," we listen to them.

Thus the Member of Congress can safely say, "Certainly, Mr. Banker, I will vote with you on this," because he will get the support of the banks, and the people don't blame him because they don't know anything about it.

Therefore, we have to have an educational campaign and let them know what a fix they have got into. The first thing you know our interest demands for the public debt will be as much as we collect in taxes and there will be no money for anything else except to pay interest on the national debt because you are carrying it up, up, up all the time.

Then there is the President, who has to deal with the Federal Reserve as best he can. As long as it goes along this way, with some Members, like me, trying to change the law, and they are under terrific fire and pressure, the President can get some consideration out of the Federal Reserve Board and the Chairman because under those conditions, they are glad to speak with him, to have meetings with him, and give consideration to his views. They know that if the President were

to join those of us on the Hill who wanted to change the laws, they would have your wings clipped overnight; you would not have a chance.

I don't think that is good for the situation to be as it is now, and I sincerely would like to have basic changes made. Now I am not questioning your patriotism or impugning your motives or questioning your honesty.

I know you are sincere in your views, Mr. Martin. I have known you over a long period of time. But at the same time you are doing something that is contrary to our form of government. You have set up an autocracy, and that kind of thing goes with fascism or communism more than with democracy.

You are doing something contrary to our form of government in maintaining an autocracy that is not answerable to the people. So, I plead with you to take another look at this thing and read the Constitution and keep in mind that the people have a right to pass on the decision of those who control their economic climate and wield tremendous power over them and make them pay these extortionate interest rates.

This poverty program, of course, is up before Congress now. It is a fine program, aimed at reducing poverty, but extortionate interest rates are causing more poverty than any other one factor that you can mention.

You take for instance Harlem; the workers in Harlem get about the same average wage as all over the United States but many of them get into the clutches of loan sharks and then the loan shark, of course, takes that check at the end of the week or month when they get it and the "deducts" move in, with extortionate interest being the main deduct, along with service charges and things like that.

So when the poor fellow gets back what is left of his check he can't pay a fair rent, he can't pay his rent. He has to go to quarters that are not as good because he has to have a lower rent.

Then the groceryman is disappointed because he does not get all his money and he charges higher prices, charges interest.

So, extortionate interest rates have caused that fellow to not only have extortionate rent imposed and extortionate terms but also extortionate prices. Initially, extortionate interest is the main cause of all that and it is getting worse instead of better.

I think that the Federal Reserve ought to give a little consideration to the people of this country who are paying these outrageous interest rates and the taxpayers who are paying an extortionate and what I would consider a usurious rate on long-term Government bonds at this time in view of the fact that we are using the Government's own credit in order to create this money to let the Government have it.

So I want you to give consideration to those things. Mr. Hayes, I notice, runs the Federal Reserve Bank of New York and the Federal Reserve Bank of New York runs the Open Market Committee. The Open Market Committee bought all these $36 billion in bonds that was mentioned here this morning. They collect over a billion dollars a year interest.

The Federal Reserve expends all it wants to without accounting to anybody or any audits. Federal Reserve banks have never been audited by a Government auditor or an independent auditor.

After spending all the money they want, the rest goes over to the Treasury. Now we are getting $800 or $900 million a year in the Treasury which is quite a sum. But the point I am making here is that Mr. Hayes runs that New York bank and all those people who work in that Open Market Committee are working for Mr. Hayes, and the law says—not a regulation—the law says they are accountable and responsible to him. Thus, the President of the Federal Reserve Bank in New York runs the show entirely.

Now then who is Mr. Hayes? He was selected by the bankers up there in New York. There are nine directors there. Six of them selected by the private banks, six of those directors, and out of the nine—of course they are two-thirds—they select Mr. Hayes. They give him $70,000 a year. That is all right. I suppose in his capacity of running the entire show he is worth $70,000 a year. He is next to the President of the United States in salary. Now of course Mr. Hayes wants to help those banks because he is selected by them. He has a 5-year contract and if he does not do what the banks want to do, at the end of that 5 years or maybe before that, I don't know, they can take that $70,000 a year job away from him.

Now if you will notice last year, in your résumé of votes, 1964, the Open Market Committee started off in the beginning with a moderate growth in bank credit, and so forth, and then some of them began to want to tighten up. April 14 they had another vote for tighter money, but the majority voted to continue it as it is.

Then on November 10, on another vote of the Board, Mr. Hayes was the only member of that Board who voted for tighter money. So we have a man in charge up there who is the tightest of all the tight money people, the tightest of all.

Mr. MARTIN. It looks like he wasn't controlling things.

Chairman PATMAN. He certainly has been controlling them to the best of his knowledge and ability. Of course, you all send him these instructions, but it is just gobbledegook nobody can understand. He does what he wants to. He has not succeeded in going as far as he would like to but he has the power up there in charge of that Open Market Committee, Mr. Martin, you know he has.

So I think you ought to reevaluate your position on this matter and consider it in relation to the Constitution, and your duty as an American citizen, as a patriotic American citizen, and I think you will come to the conclusion that you can't be for our form of Government and continue to advocate and urge exactly what you are urging, with respect to the Federal Reserve.

Of course, you have a perfect right to advocate changing the Constitution, that is all right, but you don't have the power to usurp powers as constitutional that are not. So I will just ask you to consider that if you please and see if we can't get a little better monetary growth in this country and especially with lower interest rates that will not generate more and more poverty.

Mr. MARTIN. Mr. Patman, you know practically all of those points——

Chairman PATMAN. My time has expired. Finish your statement, I will take the responsibility.

Mr. MARTIN. I will make a brief statement that all the points you have raised I have answered at one time or another in the record. To state it my way, we are a Republic as you say, a constitutional democracy.

Chairman PATMAN. How did you use democracy in that sense?

Mr. MARTIN. I said we are first a republic, we are a constitutional democracy, I mean a government by the people. And we express our general welfare in political forms and procedures and institutions.

Now one of the institutions that we have today, the Federal Reserve System, was established by the Congress, in the Federal Reserve Act. It is not clear whether we are in the executive branch or not in the executive branch.

Chairman PATMAN. Listen, Mr. Martin, you can't question that. It was passed like any other law.

Mr. MARTIN. And it has stood up for over 50 years and it is exactly like any other law. I do think the responsibility for the monetary management for the currency was given to the System. I think that we could have been set up in a half dozen different ways, but we are not different from the Interstate Commerce Commission or the Export-Import Bank or other agencies of Government. The idea was that the currency was something special, that it was to be divorced from party lines; the currency belonged to Republicans and Democrats alike. It was a Demorcatic President, one of my great heroes when I was a boy, who instituted the act, President Wilson.

By and large the theory of it was that you would have better administration of money matters to safeguard the currency that way than any other way. Now there has never been any desire on the part of the Board that I know of to flaunt this independence in the face of the President of the United States or to undermine his authority in any way. Most of the Presidents have come to respect the role of the Board and they have not wanted to take the day-to-day management of monetary policy.

Chairman PATMAN. As to your statement there about Woodrow Wilson, this is not the same act that Woodrow Wilson got passed. He got 12 autonomous Federal Reserve banks, regional banks, passed. It did not become a central bank until 1935. It is entirely different.

Mr. MARTIN. I would disagree with you on that. It has evolved through the years. Everything has changed in 50 years. But the basic framework has been the same. The country has changed. The district setup as you pointed out very rightly, Mr. Patman, has changed. But I say the virtue of setting it up this way is its independence within the Government, not of the Government, and certainly within the 14 years I have been with the System I have done my very best to cooperate with the President and Council of Economic Advisers and Treasury and to work as a team to the extent that we can.

But if we were going to be a department and be a part of the executive branch of the Government, you would make the chairman of the Federal Reserve Board a member of the Cabinet. He would not have six associate Board members. You can't go over to the White House with seven men all the time or you can't move into every negotiation with a whole squadron of people. You would have centralized authority but you would lose an important check against hasty or arbitrary action.

I think as it has been set up it has worked effectively. As I have testified up here a good many times I don't think it is perfect but I think by and large most of our foreign friends and others have felt that it was a remarkable adaptation of the American situation to a

central bank, a decentralized central bank, bringing the best judgments to bear on problems. It is cumbersome at times but this also keeps it from going off halfcocked.

Chairman PATMAN. I apologize to the other members of the committee for taking so much time. I appreciate the fact you did go ahead and answer it because you were entitled to it. If you want to add to your remarks you may do so.

Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman. Of course on this I certainly share Mr. Martin's views as I have heard him express them several times. So much emphasis has been placed on interest cost, that I think it is good to get the table in the record and the information as to who receives the interest.

For instance, of our $300 billion debt, at least $100 billion of it, which we call nonmarketable, is in savings bonds, pension plans, social security, and civil service retirement. Carrying that further, I think that it is generally our people who receive the interest and it is not just a cost item so far as the people are concerned. Do you think you could put a table in there?

Mr. MARTIN. Yes, we can get up such a table.

(The material referred to follows:)

TABLES FURNISHED BY MR. MARTIN IN RESPONSE TO MR. CURTIS' QUESTION

The first table below is confined to ownership of U.S. Government obligations since Mr. Curtis' question related specifically to that form of interest-bearing assets.

In a broader perspective, the position of the consumer as owning far more interest-bearing assets than he owes in interest-bearing liabilities is shown in the second table, taken from "The Two Faces of Debt," a booklet published by the Federal Reserve Bank of Chicago. The figures given in this second table are for the end of 1961.

TABLE 1.—*Estimated distribution of the interest on the public debt, calendar years 1941–64*

[In billions of dollars]

Calendar years	Individuals			Commercial banks	Mutual savings banks	Insurance companies	Nonfinancial corporations	State and local governments	Miscellaneous investors	Federal Reserve banks	Government investment accounts	Total interest expenditures
	Savings bonds	Other securities	Total									
1941	0.1	0.1	0.2	0.4	0.1	0.2	(1)	(1)	(1)	(1)	0.2	1.1
1946	.8	.5	1.3	1.4	.3	.6	0.2	0.2	0.2	0.1	.7	5.0
1947	.9	.5	1.4	1.3	.3	.6	.2	.2	.2	.2	.8	5.0
1948	1.1	.4	1.5	1.2	.3	.5	.2	.2	.2	.3	1.0	5.4
1949	1.2	.4	1.6	1.2	.3	.5	.2	.2	.2	.3	.8	[2] 5.3
1950	1.4	.3	1.7	1.2	.3	.5	.3	.2	.2	.3	1.0	5.6
1951	1.4	.3	1.8	1.3	.2	.4	.3	.2	.2	.4	1.2	6.0
1952	1.5	.3	1.8	1.3	.2	.4	.4	.2	.2	.4	1.2	6.1
1953	1.5	.3	1.8	1.3	.2	.4	.5	.2	.2	.5	1.3	6.4
1954	1.5	.4	1.9	1.3	.2	.4	.3	.4	.4	.4	1.3	6.6
1955	1.5	.3	1.8	1.4	.2	.4	.4	.3	.3	.4	1.3	[3] 6.5
1956	1.4	.4	1.8	1.4	.2	.3	.5	.4	.4	.6	1.4	7.0
1957	1.4	.5	1.9	1.5	.2	.3	.5	.5	.4	.7	1.5	7.6
1958	1.4	.4	1.8	1.6	.2	.3	.4	.5	.4	.7	1.5	7.4
1959	1.4	.6	2.0	1.8	.2	.3	.6	.6	.6	.9	1.5	8.4
1960	1.5	.8	2.3	1.8	.2	.3	.7	.6	.7	1.1	1.5	9.3
1961	1.5	.6	2.1	1.9	.2	.3	.6	.6	.6	.9	1.6	8.9
1962	1.6	.7	2.3	2.1	.2	.3	.6	.7	.7	1.0	1.6	9.6
1963	1.7	.6	2.3	2.2	.2	.3	.7	.7	.9	1.1	1.8	10.2
1964	1.8	.7	2.5	2.2	.2	.4	.7	.8	1.0	1.3	1.9	11.0

[1] Less than $50,000,000.

[2] Excludes $225,000,000 of outstanding unpaid interest resulting from a change in the accounting basis from an "interest paid" to a "due and payable" basis.

[3] Excludes $279,000,000 resulting from a change in the accounting basis from a "due and payable" to an "accrual" basis.

NOTE.—Figures may not add to totals because of rounding.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis.

Table No. 2

Debt in the Consumer Balance Sheet

ASSETS	billion dollars	billion dollars	LIABILITIES AND NET WORTH
Debt OWNED by consumers			Debt OWED by consumers
owed by other consumers	12	12	owed to other consumers
bonds and mortgages owed by business	30	17	owed to business in instalment credit, charge accounts and personal loans
owed by governments: Federal securities; state and local securities; social insurance reserves; currency	166	10	mortgages held by Federal government
claims on financial institutions: deposits and accounts in: commercial banks; mutuals, savings and loans and credit unions; reserves in: life insurance companies; private pension funds	383	186	owed to financial institutions for mortgages and consumer credit: commercial banks; mutuals, savings and loans and credit unions; life insurance companies; finance companies, etc.
total debt assets	591	225	total liabilities
nondebt assets (business equities, tangible personal property and real estate)	xxx	xxx	net worth of consumers

total assets = total liabilities and net worth

Representative CURTIS. Now I want to direct a little attention to what I have referred to as our "Berlin wall," this interest equalization tax and the attempt to put more bricks on it, such as your reference to the President's request for discipline on the part of the private sector.

What has always worried me, and worries me right now, is the request for discipline in the private sector with what I would regard as very little discipline in the governmental sector.

I don't know how we can really make a complete "Berlin Wall" to prevent our investment from going into climates of better freedom for investment. There was not much discipline exercised by the banks when we passed the recent interest equalization tax.

We all saw the tremendous increase in 5-year loans which caused the President to say we are going to have to implement the Gore amendment. Now, I don't quite see how we're going to be able to ask our people not to exercise economic judgments in investment abroad.

We have this serious problem. This is really cashing in on the future as Secretary Dillon recognized when he presented this interest equalization tax. This will hurt us for the future because one of our greatest assets in the balance of payments is our foreign investment portfolio.

I worry deeply about this approach. I see what happened to Britain. They had—after World War II—to put a restraint on tourism. A British person could practically not leave the country. Not only was there restriction on their investment abroad, but there were restrictions as to what people who invested in Great Britain could do with their returns.

This was just a further cashing in on the future. I would hate to see the United States embark on this form of isolationism in spite of all the rhetoric and figures of speech that are used by the public officials who are arguing for it. This is what it is, this business of putting the $100 limitation on the amount that tourists can bring bring back. As I pointed out, and the proof of it is, look how tourism continues to increase because they hit at one aspect.

The tourist spends money for travel, hotels, entertainment, souvenirs. So we put a restriction on one aspect of his expenditures. It does not do anything other than hit at a certain aspect of trade.

I just don't see, Mr. Martin, what these kinds of improvisations—buying time is what the administration says—are really going to do other than damage, in the long run, the balance of payments.

One thing that we put in the minority views of this committee a couple of years ago was the decline in return, percentage return, on capital investment, new investment, and equity investment in our country.

I think we used the years 1947–50 as a basis. It showed it to be about 14 percent. This declined to 9 percent when we had it computed. I think it has gone up a little. I am pleased that it is getting near 10. Here is the factor that brings about investment in this country plus other costs such as wage costs.

The administration is ignoring this factor in its request for minimum wage increases, increased payroll taxes, double overtime. All of these factors relate to the climate for investment. Lest my words be

taken out of context, I am concerned about employing our people, too, and we all are.

That is certainly the issue. I don't like the implication that those who prefer to follow an easy monetary policy have any greater concern for the proper employment of our people than those of us who feel that in the long run more people are unemployed through following this easy money policy when there seems to be other factors that bear on it.

Now the debate is not on this level, Mr. Martin, before this committee or even in our Nation and the President had not directed his attention to the investment climate in our own society. This it seems to me, is the main thrust, must be the main thrust if we are going to get a favorable balance of payments.

The other day—I forget who was interrogating one of our witnesses—Dr. Saulnier called to our attention a study of the Brookings Institute on how our foreign investment is directly tied in with our exports. Not only do we gain from the return on our good investments abroad but our exports, which is the other plus in our balance of payments, are also dependent upon foreign investment.

So I just wonder at this business of talking about imposing or requesting voluntary compliance on the part of our leaders in industry. We are asking them to follow a unique economic course, at least as far as long range is concerned, which is not really designed to hit at the basic problem at all.

It is temporizing. Now what are we doing with the time that the President is discussing? He is asking us to buy time in order to get over what he thinks is the hump in this serious problem, the balance of international payments. What is the program that he is proposing to deal with the basic disease, not the symptoms?

Mr. MARTIN. Well, this is a very difficult overall problem but I think the President has spelled out his program in his 10 points. He has come out on the wage-price spiral.

Representative CURTIS. How has he, when he comes out with the request for increasing the minimum wage, double time for overtime, and an increase in the payroll tax? You can't ignore that those bear right on the very point.

Yes, I am interested in trying to uplift the wages of our people but, in these times is that doing something about the wage-price spiral or isn't that increasing it?

Mr. MARTIN. I was talking about the guidelines which are fundamental. I say the President has taken a strong position on that.

Representative CURTIS. Let me argue a bit further with you on that because that is the point, requesting, again, discipline on the part of the private sector and then showing no discipline at all in the governmental sector.

Quite to the contrary. It is requesting discipline at the private level at the very time the Government policies are designed to do just the opposite. Am I not fair in saying that there is a relationship to requests for these programs, that the President has asked for in his domestic budget?

Now, how can you talk out of one side of your mouth on one thing and then out of the other side on the other because I think that is what we are doing?

How do you figure he is taking a strong position? I don't regard it as a strong position when he says that you in the private sector exercise caution on wage-price guidelines while in his programs he is increasing the wage cost.

Mr. MARTIN. The President has taken a strong position on labor and management, on the necessity of keeping the price level in line with productivity. He has always taken a strong stand now in favor of enterprise.

Representative CURTIS. He has also asked the Congress to increase the payroll tax by probably over 1 percent and increase the bases. Now that is increasing costs and it is increasing wages without any relationship to productivity increases. Nor does he relate his request for double time to productivity increases.

That is my point.

Mr. MARTIN. It is a very difficult overall problem, Mr. Curtis, that is the point I am making. I think there is no question that the President wants to grapple with it.

Representative CURTIS. He comes in with further deficit financing in a period of an economic upturn. This, of course, creates inflationary forces. Whether they actually come out in the consumer price index is dependent on how much you can improvise in debt management and monetary policy. It puts a strain in both places.

Now, I can't describe the President's statement of wanting wage-price guidelines with the actual budget which he has presented to the Congress.

It is a deficit budget in a period of economic upturn. In its details it relates to increasing wage costs without reference to productivity increases. Now this is what bothers me.

If you have any further comments I will be pleased to receive them.

Mr. MARTIN. I have none other than the fact that there are inconsistencies in a lot of other things but basically I have no question that the President is anxious to deal with this basic problem of our competitive strength.

Representative CURTIS. I think he is anxious to deal with it. The issue is whether or not the proposals he has made, and is making, are really the kinds of things to improve employment. Sure, he is a perfectly sincere person and my colleagues over here who disagree with me are. They don't imply that they are more concerned about getting our people employed than I am.

We are all interested in moving forward. The debate should lie in these areas of policy. When I make these remarks worrying about increasing the minimum wage, I can just see the manner in which this will be taken out of context, "Congressman Curtis does not care about the fact that a lot of our people are not making much money," and so on.

I am deeply concerned. The debate should be over whether these policies are the kind that are designed to produce the results that we all want to produce and the debate I regret to say, is not on this level, yet.

My time has expired. Thank you.

Chairman PATMAN. Senator Douglas.

Senator DOUGLAS. No questions.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. I have just one question. I have read that some have suggested that we might have an occasional increase in the value of the dollar in relationship to gold. That is, to provide for $34 or $33 for an ounce of gold. We would never go above $35. What that would do it seems to me is tend to reduce the value of the gold hoardings and to undermine confidence a little bit in gold and perhaps it would discourage speculation, particularly if we made it crystal clear that we would not go above $35 an ounce.

Has that been discussed at all?

Mr. MARTIN. I have not discussed it. Would you like to comment on that, Ralph? Have you heard that discussed?

Mr. YOUNG. It has been suggested by a number of people. It is hard to see how it would work. It might have the reverse effect.

Senator PROXMIRE. It might have a reverse effect?

Mr. YOUNG. My comment was to the effect that instead of accomplishing the purpose of deterring speculation in gold and private hoarding of gold, that the effect of this might be just the opposite.

Senator PROXMIRE. Why? If we made it absolutely clear that we are not going to decrease the value of the dollar, that if anything we are going to increase the value occasionally?

Mr. YOUNG. In our present international payments situation, we would not buy any gold, none would be offered to us. So, the gold that would become available on the world markets, there is not so much of it, would be taken up by other parties, other monetary authorities, and by hoarders of gold who would be aware of our gold position—namely, one of selling gold because of our balance-of-payments position. Another factor is that we could not adopt such a plan without violating our agreement with the IMF, which would be a very serious matter, I think you will agree,

Senator PROXMIRE. I wish this were not all so logical. If this could be a threat without doing it it would be a help—if this were an option. It is something we might seriously consider.

Mr. YOUNG. It is not a practicable option.

Senator PROXMIRE. That is too bad. Thank you.

Chairman PATMAN. Tomorrow morning at 10 o'clock we will meet here. Tomorrow is Saturday. It is the last day of our hearings. Normally we have a report required by law on the 1st day of March which is Monday but yesterday Senator Douglas got permission of the Senate and I got permission of the House to pass that over until March 17. We have until March 17 to file our report. Tomorrow we have, of course, Mr. Keyserling and Mr. Voorhis.

We want to thank you, Mr. Martin, and the gentlemen accompanying you for your testimony. We appreciate it very much. You may rest assured it will be carefully considered, sir.

(Whereupon, at 12:45 p.m., the committee recessed until 10 a.m., Saturday, February 27, 1965.)

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THE PRESIDENT'S ECONOMIC REPORT

SATURDAY, FEBRUARY 27, 1965

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

The Joint Committee met at 10 a.m., pursuant to call, in room AE-1, the Capitol Building, Hon. Wright Patman (chairman), presiding.

Present: Senators Proxmire, Jordan, and Miller, and Representatives Patman, Reuss, and Griffiths.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

Today the committee completes its hearings on the President's Economic Report with two outstanding Americans, both of whom have served their country in distinguished capacities.

It is indeed an honor and privilege of this committee to welcome as its first witness today the distinguished Mr. Jerry Voorhis, who was a Representative from California in the 75th through the 79th Congresses. He is a graduate of Yale University and Claremont College and served in many capacities in various parts of the country.

In addition to his congressional service, since 1947 he has been executive director of the Cooperative League of the United States of America and executive secretary of the Cooperative Health Federation of America.

We have invited Mr. Voorhis to testify here today as one of our most informed citizens, as a former Congressman with an economic background to provide the committee with some practical views as to what we should do to carry out the goals of the Employment Act of 1946.

Mr. Voorhis, it is indeed a pleasure to have you with us again. You may proceed with your statement in your own way, sir.

Mr. VOORHIS. Thank you, Mr. Chairman.

I would like to be indulged to engage in just one reminiscence, if I may. I did have the honor of serving in the House for 10 years. If I ever accomplished anything it was due to two experiences that I had right at the very beginning. I did not wait as long as freshmen are supposed to, to make my first speech. I made it on some of the subjects that I am going to discuss today. The House was virtually empty at the time.

Of course, the Speaker still had to be there. About halfway through my speech Speaker Bankhead got someone else to take the chair and went down and sat on the front chair and listened to the thing to the bitter end.

The second experience was that at that time in the 75th Congress the chairman of this committee had a bill to straighten out the Federal Reserve System, which he still has, and we formed a committee to try to pass that bill. I was an eager beaver young Congressman, I guess. Anyhow, Congressman Patman asked me to be secretary of that committee and gave me the privilege of writing a statement that he delivered in the House about that. If it had not been for those two experiences I don't think I would have ever been able to function as a Congressman. At least not as well as I hope I was able to do, nor nearly as soon.

So, I was more grateful for those expressions than I can tell you.

Chairman PATMAN. May I interrupt you to say that you were looked upon as a very valuable, knowledgeable, intelligent, sincere, and honest Member of Congress from the time you came, Mr. Voorhis.

We had confidence and trust in you. I don't know of any Member of Congress, although you and I differed with most Members on these controversial questions, I don't know of any Member of Congress who was looked upon more highly and with greater respect than you from the time you got there until you left, and even now.

We are glad to have the benefit of your knowledge back here today.

Mr. VOORHIS. Thank you very much, Mr. Chairman.

STATEMENT OF JERRY VOORHIS, EXECUTIVE DIRECTOR OF THE COOPERATIVE LEAGUE OF THE U.S.A.

Mr. Chairman and members of the Joint Committee: My name is Jerry Voorhis and my job is executive director of the Cooperative League of the U.S.A. Six years ago I requested of Senator Douglas, who was then serving as chairman of this all-important committee, opportunity to present testimony on behalf of the Cooperative League. In that testimony I endeavored to show—indeed I am confident I did show—how the influence of various kinds of mutual and cooperative enterprise contributes markedly to the growth of our American economy, to more nearly full employment, and to more economic pricing of goods and services, and to strengthening the economic bargaining position of our farmers.

In my testimony today, I am speaking as an individual citizen, a former Member of the House of Representatives, a father and a grandfather concerned about the future of our Nation. I am indeed proud to have been accorded this opportunity—particularly since I value so highly the courageous constructive leadership in the field of monetary and fiscal policy which the present chairman of this committee, Mr. Patman, has given us through so many years.

I shall not be relating my testimony today in a direct manner to my job or the work of the Cooperative League, except that I should like at the very outset to give one illustration of a point that will be central to all that I shall have to say.

It relates to the war on poverty.

We all know that the best kind of assistance that can be given to any group of people is to help them to discover how they can help themselves. We believe that we know the ways whereby this can be done for the poor and disadvantaged people of this country. It is a simple method. It has been used successfully for many years by the

farmers and fishermen and miners of Nova Scotia, and by the members of the Farm Bureau in Ohio, by countless groups of people in many parts of the world. It is, broadly speaking, the Peace Corps method. The method consists of gathering together a group of people, developing among them a feeling of trust and confidence in one another, helping them through study and discussion to decide for themselves where the causes of their problems lie, and then guiding them in the undertaking together of such projects and enterprises as will most immediately directly and practically begin to meet their needs. We, in the Cooperative League, have no monopoly on the method of cooperation. But we do know that it works and we believe we know the techniques of making it work. We believe that the use of the study-action neighborhood groups method could be made a master key to unlock the door from poverty into a better life for many, many families in both rural and urban America.

There is only one reason why we must limit ourselves to a few pilot demonstrations of this method—only one reason why we do not launch a nationwide drive against poverty through group self-help and self-determination.

That reason is that we do not have the money with which to do so—not a tiny fraction of enough.

The National Probation & Parole Association recently issued the following statement:

> Delinquency among children is skyrocketing at four times the rate of national population growth. The number of children hauled into court has doubled in 10 years. Three of one hundred youngsters between 10 and 17 will be adjudged delinquent this year. One out of every nine in this age group already has a delinquency record. The acceleration of delinquency is just about as urgent as a problem can get.

On February 13 the Chicago Daily News ran a front page article on this subject. It pointed out that there is a waiting list of 14,000 children in Chicago who were referred to the Bureau of Child Study for Psychological Testing at the close of school last year. There simply aren't enough—not nearly enough—trained social workers or facilities to touch the need. The article says that experts in this field believe it would require every available resource just to safeguard today's preschool children against becoming delinquents a few years from now.

The remedial programs—the Job Corps, the Neighborhood Youth Corps, the work study and work experience programs, VISTA—provided in the Economic Opportunity Act are exactly the right kind of programs.

But unless they are vastly expanded soon beyond their present scope, they will be "too little and too late."

For these reasons the main point which I shall try to make in this testimony is this: We need—desperately—the maximum growth rate, the maximum expansion of production, the maximum amount of creation and conservation of resources of which we, as a nation, are capable. We need to close as fast as we can the "gap" between actual and potential gross national product.

For while neither private organizations nor local governmental bodies have anything like the necessary resources to deal with our problems, we, our Nation as a whole, are probably capable of generating most of the resources we need if we can achieve the rate of expansion of which—as the report before you clearly indicates—we are capable.

The Economic Report of the President and the Annual Report of the Council of Economic Advisers which this committee has now under consideration have three characteristics which, while not altogether new or unique, mark them as different in degree if not actually different in kind from all previous reports submitted to the Congress since the present chairman of this committee guided the Employment Act of 1946 to passage.

First, these reports, more than any of their predecessors, are much more than economic reports. They are reports about human beings in the United States—about what has happened, what is about to happen, and what should happen concerning those people's lives.

Second, these reports, more than any that have gone before them. breathe an air of confidence in man's ability to master his problems and guide his destiny. And it is a confidence derived from solid, demonstrable, recent experience. It is a confidence, that for the first time in human history, a truly Great Society can be realized for all the people.

Third, these reports, as no others before them, point directly at monetary and fiscal policy as the key to the kind of governmental action, which, without limiting one whit the freedom of independence of anyone, can combat recession, sustain and accelerate economic growth, and bring effective demand more nearly into balance with potential supply of goods and services.

Let me illustrate these three points. In the introduction to the report the quotation chosen from President Johnson contains these characteristic sentences:

> The Great Society rests on abundance and liberty for all. It demands an end to poverty and racial injustice. It is a place where every child can find knowledge to enrich his mind and enlarge his talents.

A little later on the report says:

> Economic policy must support human compassion in the attack on poverty. Education of every human being to his full potential is a central goal.

And in the conclusion, titled "perspectives," we find the report saying:

> Most important is the need to develop the potential of human beings.

There is little need to repeat here the facts about poverty. A few short years ago there would have been great need to do so. For we were a complacent people, and we had almost forgotten some 35 million of our fellow citizens and the bleakness of their lives. But today Appalachia seems very close at hand. So do the communities of the cut-over country of the far North. So do the slums of our great cities. The report reminds us that one-fourth of the Nation's children live in families that are below the $3,000 poverty line. We have learned to feel those children very close to us.

To me there is something almost prophetic about the change that has come over us. At the very moment when we were in the greatest danger of becoming a careless people, a people softened and weakened by too much luxury, a people lacking a sense of God-given purpose—at that moment the President laid before the Nation as noble and right a challenge as any nation was ever given. He called us to fight an unrelenting war on poverty, to marshal our resources, public and private, material, moral, technical, and spiritual, and to resolve not to cease our efforts until needless poverty has been banished from our

land. And in the Economic Opportunity Act, passed by the last Congress, it was clearly recognized where the "poverty cycle" must be cut. For that cycle consists of a vicious relationship: Families who are poor cannot afford education and training, and those who lack education and training in today's world are likely to be doomed to poverty. So the war on poverty is to be fought in large part through education and training, through providing the educational opportunities which will enable the children of this generation's poor to break out of the poverty cycle that has afflicted their families.

But while all the methods of attack on poverty which Congress adopted are right ones, it is evident enough, from the estimates of the number of young people who can hope to benefit from the present program as given in the report, that a program of four or five times as large as the one now provided will be needed before we shall see education and training begin to really win the war.

The judgment of God would surely come upon a nation where a prosperous four-fifths of the people neglected needlessly the one-fifth of its fellow-citizens who lived in poverty. And the practical result of that truth becomes clear when we realize how intimately related and interdependent are the war on poverty, the employment of the unemployed, the achievement of a satisfactory rate of economic growth, and the sustaining of general economic prosperity. We need to have those who are now poor and unemployed as part of the active labor force and as consumers of a decent share of the goods and services we could and should produce if any of us is to be assured of sustained economic welfare. This is as it should be. The Great Society has got to include everyone.

It is significant, that the last paragraph of the entire report says:

> We have the means to break the bonds that tie today's children to the poverty of their parents. With proper measures we could eliminate poverty in the next generation.

I would add one word: "With enough of the proper measures we could eliminate poverty in the next generation." Previous generations might be excused for permitting poverty and want to continue. Our generation cannot be so excused. Our forefathers lacked the means, the resources, and the knowledge. We do not lack these things. The only question is whether we will use our knowledge, our resources, and our productivity to the full. For unless we do that we cannot win the war on poverty. Poverty cannot be dealt with as if it were an isolated phenomenon.

The only hope we have of rural area development, or of solving the problems of Appalachia, or of providing each child the education of which he is capable, or of eliminating the slums, is through a sharp increase in our general economic growth rate.

The report deals at length with the sustained prosperity and rising economic growth which has marked the past 4 years. The record is documented as to how this was achieved. The report says, in effect, that we know how to bring about such an increase in gross national product as the $4\frac{1}{2}$ percent which was achieved in 1964 over 1963. And both the President and the economic advisers predict with confidence that a gross national product of about \$660 billion will be achieved in 1965. The President tells us that "our tools of economic policy are much better tools than existed a generation ago. We are

able to proceed with much greater confidence and flexibility in seeking answers to the changing problems of our changing economy."

One such tool above all others has made these achievements possible. The report states it in these words:

> The lessons of 1964 will not soon be lost: Fiscal policy can sustain growth and raise spending power to the levels needed to use our resources more fully.

On page 80, the report states that in 1964 our economy received "the largest fiscal stimulus ever provided in peacetime." A considerable part of that stimulus, of course, came from the tax reduction provided in the Revenue Act of 1964. And the basic reason why it was necessary is stated on page 62 of the report in these words:

> Thus in the last 4 years the main challenge to U.S. policy has been to stimulate a massive growth in total demand, sufficient not merely to keep up but to catch up with the growth in productive capacity.

May I add that that same exact challenge is the one we face in the next year and the next 4 years, and every year thereafter into the foreseeable future.

The tax cut and other expansion policies were necessary to sustained prosperity because the growth in total demand would not otherwise have kept up, let alone caught up with the growth in productive capacity.

The tax cut did a reasonably good job as the gains of 1964 proved. But it did not do a good enough job. It did not give enough stimulus to overcome unemployment or to activate idle productive capacity. Nor, if we are concerned about the war on poverty, is a tax cut the best method. A tax cut benefits mostly the higher income groups. It stimulates their demand and their investment. But it is less direct in its effects upon the poor, whose demand most needs stimulation, than would be increased expenditures upon the Job Corps or the work study program or upon slum clearance and urban renewal, or health centers, or area redevelopment, or the training of youth counsellors, doctors, or nurses. The fiscal effect upon the economy is the same from a tax cut or from public expenditures in the war on poverty. But the effect in the raising of the quality of our Nation's life may be quite different.

The economic record of the past 4 years, particularly the last 2 years has, on the whole, been a good one. But the President has raised our sights and set for us far nobler goals: the end of poverty, full educational opportunity for every child, a beautiful America, to name but three.

And on page 39 of the report, we therefore read:

> Unfortunately, the balanced growth of the U.S. economy in recent years, unlike the sustained progress of other industrial economies, has occurred at too low a level. The excessive unemployment and idle capacity with which the current U.S. expansion began have not yet been fully erased. Unemployment at 5 percent of the civilian labor force is far better than the 7-percent rate of spring 1961. But 5 percent represents 3.7 million persons seeking work. If unemployment today were at the interim target of 4 percent, the number without jobs would have fallen below 3 million, and the labor force would be considerably larger than it is today, as emerging job opportunities encouraged more people to seek work. Consumer incomes and corporate profits would both be considerably higher. The gap of $25 to $30 billion that still remains between the Nation's actual output and its potential output would be closed. The size of this gap—4 percent of our current potential—is a measure of the primary challenge for economic policy: achieving maximum employment, production, and purchasing power.

A second challenge—not new, but more fully recognized than ever before—lies in the contrast between our great overall prosperity and the poverty and misery which still afflict too many families, and in the contrast between our great material achievements and the quality of our private and public lives.

A gap of $25 billion a year—or $51 billion as it was in 1961—between what we do produce and what we already have the capacity to produce is a rather important matter. It can be the difference between winning or losing the war on poverty. It can be the difference between a favorable and unfavorable balance of international payments. It is the difference between excessive unemployment and reasonably full employment. It could finance the scope of education and training program we need to break the poverty cycle. It can be the difference between hope and frustration, between pockets of poverty and the Great Society.

We can have the resources to end poverty in our country. We can have the resources to provide for each American child the education needed to develop his or her talents to the full. We can have the resources to make ours a truly beautiful country.

Why then do we not actually plan to close the gap in gross national product, develop the education and training system which our children need and deserve, and abolish the blight of poverty in accordance with the challenge of our President?

There is, I believe, one basic reason why we have not done so, and why, even now, we may not do these things. That reason is that we do not really believe these achievements are possible. We think that, even as a great, fantastically productive nation that we do not have the money. We are not as yet prepared to take enough of the proper measures whereby the report tells us we could eliminate poverty. We are not ready to take up fully the "main challenge to U.S. policy"—which the report says is "to stimulate a massive growth in total demand."

We are, it is true, in a far better position to do this than we were even a few years ago. The administration of President Franklin D. Roosevelt recognized for the first time in our country's history that the fiscal operations of the Federal Government could and should be used to stimulate economic activity, increase employment, and overcome depression. The only trouble was that we used this policy too sparingly and that we tied all the expansion of money and credit to increases in our debt.

The Eisenhower administration adopted a policy of attempting to expand the money supply as rapidly as the real wealth economy of the country called for and justified. But again, no other basic method of bringing this about except further increases in debt was used.

A few years ago, without publicity and without many people even knowing about it, the Federal Reserve System began paying into the Treasury a considerable percentage of its profits—thus recognizing at last that the Federal Reserve Board, the Federal Reserve banks, and the Open Market Committee are all exercising powers of money creation which properly and constructively belong to the Nation and the people as a whole.

And I have already pointed out several times in this statement how important a forward step in this Nation's economic life is marked by the unqualified statement in the report before you that "fiscal policy

can sustain growth and raise spending power to the levels needed to use our resources more fully." All this is indeed progress.

But just as our best hopes lie in the field of monetary and fiscal policy, so it is also in that field where our most serious failures may well take place. Some of them are taking place right now.

For one thing we fail, I think, to realize how important a factor in our economic life debt has become. This is true all the way from the Federal Government to the poorest family. The gross public debt of the Federal Government exceeds $300 billion and interest on that huge debt now takes 11 percent of our total annual budget. Farm mortgage and production debts have trebled since 1950. In 1946, consumer debt was $8 billion. It is almost $80 billion today. Nonfarm mortgage debt was $32 billion in 1946. It is $260 billion today.

So what? If we had consistently followed the low-interest policy which was in effect prior to 1952, the debt would not need to concern us quite so much. But we did not.

And the increase in interest rates has cost us an additional $16 billion in interest on the Federal debt alone over the past 11 years—enough if used in better ways to finance a very big campaign in the war on poverty.

An increase of only ¼ percent in interest rate now adds about $800 million to the interest bill paid by the taxpayers of the Nation to the holders of our bonds and notes. Related to the rise in interest rates is the fact that our money supply has been increasing much too slowly. Prior to 1963, the money supply—tied as it is to our debt—had increased on the average only about 1.8 percent per year for almost a decade. This is not enough, certainly, to stimulate or accommodate an annual growth rate in the real wealth economy which ought to be three times that figure. The rise in interest rates has been, in part, a result of restrictive monetary policies, and vice versa.

But it is not the public debt alone that should concern us, but private debt as well. It is very true that but for the increase in debt that has taken place we could never have expanded demand for goods anywhere nearly enough to sustain the growth which our productive economy has had. But this only makes the situation the more serious. For if we are dependent upon these astronomical increases in public and private debt for our prosperity, then the absolute necessity of considering policy with respect to debt, interest, money, and credit becomes all the more apparent.

I have little doubt that it is true, as some economists have estimated, that about 15 percent of all consumer disposable income is now obligated for payments on installment and mortgage indebtedness. Nor that as much as 30 to 40 percent of their incomes are so obligated by millions of our poorest families. The charges upon such debt become a life and death matter then, and there is no time to lose in studying those charges and exposing abuses related to them. A very long step in the war on poverty could be taken if our poor families were protected from the extortionate interest and "carrying charges" with which they are so often saddled when they buy their furniture or their refrigerators or when they borrow money from agencies other than credit unions, banks, or savings and loan associations.

Many lurid facts and statistics could be given here. The report itself alludes to them on pages 137 and 138 where it states that "the

truth in lending bill would eliminate many of the abuses in the credit area."

But two sets of facts should suffice.

First, as recently revealed by the Chicago Daily News, the U.S. district court in Chicago is currently handling no less than 1,000 bankruptcy cases each month. And 90 percent of them are cases of wage earners seeking relief from garnishment of their wages to pay extortionate charges on installment purchase contracts.

Recently Mrs. Helen Nelson, of the Consumers Council for the State of California, conducted a careful study of the costs to California families of financing charges. The study revealed that in our "buy now-pay later" economy the average family of middle and lower income is paying installments on a number of purchases. Typical was found to be the family paying, by installments, on a refrigerator, a used car, home furnishings, and money borrowed to pay medical bills. At average prices and within the limits of the law credit costs on these items together were found to average $467 a month. Median family monthly income in California is $488. One month's income goes to pay, not the cost of goods and services, if paid for in cash, but only for the interest—or "carrying charges" which is another name for interest—on the transactions. Few families understand the extent to which interest and financing charges are sapping their incomes and their buying power. The poor ones understand it least of all. Senator Douglas' truth in interest bill would help them. It should be promptly passed, as the report recommends.

The California study just referred to pointed out that whether or not a child can go to college may well be determined by the rate of interest paid on a home mortgage. A 15-year mortgage at 6 percent, instead of 7 percent, can save a family, through that 1 percent reduction, no less than $3,500.

The experience of the housing cooperatives in New York City and elsewhere—and I am sure the experience of other builders—shows that a 1-percent difference in the interest rate on the mortgages make a difference of $2.25 per room per month in the monthly charges. On a three-room apartment, this would amount to $81 a year. We are proud of the record that our housing cooperatives have made, in replacing slums with fine neighborhoods of garden apartments at monthly charges—for homeownership—of about $60 for a three-room unit. This is often less than the families paid for miserable slum dwellings. But just a 1-percent addition to the interest rate amounts to considerably more than 1 whole month's rent for the families we are trying so hard to rehouse.

So interest rates are of prime importance in our economy today. They are of basic importance to the realization of the "massive growth in demand, sufficient not only to keep up but to catch up with the growth of productive capacity" for which the report calls. They are of critical importance in the war on poverty. It is time we realized the central importance of debt and interest in our economy today. It is time we realized that, far from curtailing inflation, an increase in the interest rate will enter into practically every element in the production-consumption process and actually cause pressure toward inflation of prices. The remedy for any inflation that might conceivably threaten us—and none is likely since, as the report says, "fiscal and

monetary policies are in the next few years, likely to face the continuing challenge of providing stimulus to markets rather than of restraining excessive growth of demand"—but should inflation threaten its remedy is not increased interest rates but direct action by the Federal Reserve Board to increase requirements for demand deposits in the commercial banks.

To ease the burdens and the cost of consumer debt, it should be national policy to encourage people to join credit unions where they exist and to form them where they do not yet exist. For through credit unions the people's own savings can be brought together to form a pool from which they can borrow, in effect, from their neighbors and themselves at decent rates of interest, escape the extortionate financing charges of which I have been speaking, and build their financial resources at the same time.

The Small Business Administration should be expanded, its lending rates reduced, and its operations extended to small business enterprises of all kinds, including cooperative businesses—especially in redevelopment areas and areas of economic need.

One of the finest acts Congress ever passed was the Farm Credit Act. For as a result of the cooperative Farm Credit System most farmers can obtain credit at reasonable interest—and from institutions which they themselves own. But in many parts of our country there is need to help small and poor farmers to make far better use of their production credit associations—and in many cases even to join them for the first time.

Title III of the Economic Opportunity Act—providing low-interest loans to needy farmers and in areas of rural poverty—is right legislation. But its present scope is so small as to be barely a drop in the bucket of the need—once its benefits are understood by the people who are eligible.

So, Mr. chairman, what I am here advocating is a policy of using the lesson we learned in 1964, but using it more effectively. I believe monetary and fiscal policy can stimulate our economy. I believe it can and should be used to stimulate our economy until unemployment has been overcome, poverty actually pushed back, and the "gap" between our actual and our potential production closed.

But I believe these objecives can only be realized if we resolutely follow a low-interest rate policy, especially where the war on poverty is being waged.

I believe also that such a goal of a fully dynamic economy is going to be possible only if we assure ourselves of an adequate money supply, and if we learn the difference between credit and debt.

John Adams, second President of the United States, once said in a letter to Thomas Jefferson:

> All the perplexities, confusion, and distress in America arise, not from defects in their Constitution or confederation, not from want of honor and virtue, so much as from downright ignorance of the nature of coin, credit, and circulation.

John Adams said that a long time ago, and much experience has been had since he wrote his letter. But, I believe that we can still learn one central lesson from it.

For we still confuse credit and debt in much of our thinking. And as a result of this confusion we find ourselves continuing to doubt that we really can build the Great Society. We continue to ask:

"Where are we going to get the money?" And we continue to doubt that we actually can. This is our greatest barrier to steady, confident progress.

This concluding section of my testimony will be a fairly simple proposal to get our national bookkeeping straight.

Let me begin with an illustration. A farmer who owns his farm decides he needs to borrow $10,000. He goes to his bank for that purpose. The bank agrees to lend him the $10,000 if the farmer will secure the loan by giving the bank a mortgage on his farm, which is judged to be worth something over $10,000. So the bank writes up a demand deposit on its banks in the amount of $10,000 and gives the farmer a passbook showing that he has that amount of what we call money in the bank. The bank has created that amount of money. But the bank did not extend credit to the farmer. He had more than $10,000 credit already, represented in this case by the value of his farm. If the farmer does not pay his debt, the bank will foreclose, sell the farm, and get back the $10,000 it created for the farmer's use.

Again, the bank did not give the farm any credit. What it did was to monetize the farmer's own credit. This was a convenience to the farmer, of course, because we don't permit private individuals to monetize their own credit. Only banks can do that. And for its trouble in handling the farmer's checks and caring for his account, the bank is entitled to be paid. But to conceive that the farmer is paying interest to the bank because the bank had credit and the farmer didn't is wrong.

Now in some cases loans are made not upon security but upon what we call the character of the borrower. What we mean by this is that borrower is honest, that he is willing and able to work, to produce, and to earn enough so that he can repay the loan. Even in such a case it was not the lender that had the credit, but the borrower. He was considered to be "credit worthy" as we say. And the lending institution simply monetizes—that is, turns into a generally accepted form of exchange—the credit of the borrower.

The credit of anyone consists basically of his ability to produce real wealth—or his possession of it already—and his dependability in repaying a loan.

Now where dealings among private individuals and private lending institutions are concerned, we may only wonder why borrowers are called upon to pay quite as much as they usually are to borrow what is actually their own credit. The reason—or excuse—for this is, of course, that there is some risk involved. The borrower might not pay. And the lender protects itself against that possibility.

But let us consider what happens when the Government of the United States finds, as we do today, that each year our economy is growing, the productivity of the Nation is growing, and that, therefore, an additional amount of money—or purchasing power—must be injected into the economy in order to "sustain growth and raise spending power to the levels needed to use our resources more fully." Obviously what has happened here is that the credit of the Nation has been increased.

And since the Constitution specifically charges Congress with the power and the duty to "coin money and regulate its value," and since that essential prerogative of sovereignity is nowhere given to any

other agency, one would expect that if the credit of the Nation increases, the Nation itself would monetize that credit and use it to provide the additional spending power needed to sustain growth and assure more full use of our productive capacity. Even though farmers can't monetize their own credit, it would seem inescapable that Uncle Sam could do so. He is supposed to be sovereign.

But that is not what happens at all. Instead, we increase the Nation's debt in such cases. And we worry because we seem never to be able to reduce the Federal debt or—very often—to balance the budget, even in times of reasonable prosperity, when indeed it should be balanced.

The reason is obvious. The more active the economy is and the more rapid its growth, the greater is the need for an addition to our money supply to keep pace with the real growth of the real wealth economy. So as long as we persist in designating as "debt" what is actually the Nation's credit, we shall never escape the necessity of increasing constantly the Federal debt. In fact, the only way to do that would be to permit the economy to collapse.

The way the whole rather ridiculous procedure is carried out is, by having the sovereign Government of the United States print bonds and give them to private banks, which then create demand deposits and use them to purchase the Nation's bonds, which are in turn used to back the deposits. This increases the volume of our checkbook money and stimulates the economy as is necessary to do.

What has happened here is that the commercial banks have monetized the Nation's credit—everybody's credit—and used it to buy evidences of the same Nation's debt. This costs the banks absolutely nothing. In fact, a banker friend of mine once, during World War II, complained to me that interest rates on Government bonds were too low. I asked him what his bank did about this. And he replied quite honestly "We just buy twice as many bonds." No preexisting money was needed by the bank to do this. It simply created it, and lent it, with no scintilla of risk whatsoever involved, to the Government and people of the United States.

The anatomy of this strange procedure is well enough known, I am sure, by the members of the committee. But for the sake of completeness here it is.

Our present monetary system makes our whole economic welfare dependent upon increasing debt. Under our present system it is only by expanding debt that we can obtain the money supply which is necessary for adequate growth and maximum employment. Our money is manufactured by the private commercial banks of the country when they make loans and even when they make investments other than out of savings deposits. This rather strange and almost certainly unconstitutional method of giving away the basic public function of money creation to private interests results from the fractional reserve system on which our commercial banking system operates. This means that banks are required to have on hand or in reserves only a fraction as much money as they are allowed to lend and invest. The rest of the checkbook money they use to make loans and investments is literally "manufactured" by the banks by writing figures in their books of account.

The chairman of this committee, Mr. Patman, has demonstrated this repeatedly in his speeches, one of the best of which was his "ABC

of America's Money System," delivered in the House, August 3, 1964. With reserve requirements fixed by the Federal Reserve Board—usually at less than 20 percent—commercial banks can manufacture demand deposit credits almost at will and lend into circulation at interest. With a 20-percent reserve requirement in effect the banks are able to lend about five times as many dollars of newly created checkbook money as they possess in reserves of actual cash or credit on the books of the Federal Reserve banks. Thus when the banks buy Government bonds they use the credit of the Government and the people—and exercise the power to create money—with which to buy them. The interest they receive amounts to an outright subsidy by the Nation to the banks. It is a payment of interest by the Government upon its own credit.

In 1951 interest on the national debt was about $5⅔ billion. It was $11 billion in 1964, due principally to increased interest rates.

Because the Nation has thus given away its money-creating power it is presumed that it must not itself exercise that power. At least it never does so. The closest we ever come to doing so is when the Federal Reserve banks create new reserve bank credit. For while the Federal Reserve banks are wholly owned by the private banks of the System, they are, nonetheless, subject to some degree of public control, through the Congress and the executive department. As long as the Federal Reserve Board and banks recognize themselves as exercising the essentially public and governmental function of creating and controlling money, there is a chance of the System working reasonably well, except for the chronic problem of ever-increasing debt.

But in order for this to be the case, the Reserve System must act in the public interest rather than that of the private money-lending agencies of the country, which is the reason for the legislation currently being proposed by the chairman of this committee.

There have been times when the Federal Reserve Board came close to doing this. There was a time when its governmental power was used to maintain the price of Government bonds at par and thus to prevent any necessity for raising interest rates thereon. As long as everyone knew that the Federal Reserve would use its essentially governmental power to provide a market for Government bonds at par, they could be sold elsewhere at par. And it was not "necessary" to increase their interest yield in order to sell them.

But this practice was abandoned about the year 1952, allegedly as a counterinflationary measure.

But, there was a way in which any danger of inflation could have been directly avoided if the Federal Reserve Board had used it. This was the power of the Board to increase reserve requirements in the commercial banks. By increasing reserve requirements the privilege of the banks to create more new money can be directly and certainly curtailed.

But the Federal Reserve Board, crying loudly about the "danger of inflation," actually reduced reserve requirements instead of raising them. On the other hand, it increased interest rates on the excuse that this was "necessary" to control "inflation." Enough has been said to make quite plain why the Board was wrong in both decisions and why its course was more likely to cause inflation—at least price inflation—than to prevent it. Incidentally, the profits of commercial

banks rose from less than $300 million in 1949 to a record high of about $1,400 million in 1958. They hardly seemed to need favors.

It is difficult to see how we can assure adequate rate of growth and maximum employment with reasonable price stability as long as we rely on the debt-money system we now have. Increasing debt is the price that must be paid to bring needed money into existence and make economic growth possible. The synthetic money created in this process is subject to sudden destruction by the simple process of reduction of debt. And the U.S. Government, meanwhile, forces itself to pay interest on its own credit. It is time some changes were made.

The Government of the United States should assume responsibility for creating from time to time, by its own action and without expanding its debt, enough new money—and no more than enough—to accommodate the expansion of productive capacity in the economy and maintain reasonable price stability. Until this is done there is no possibility of balancing the budget, even cyclically, nor of preventing a continuous increase in the national debt—unless we decide to bring on a depression.

Under such scientific monetary system it would become possible gradually to reduce the mountainous burden of our present national debt. It would also be possible to guard effectively against either monetary inflation or monetary deflation. And it would be possible actually to win the war on poverty.

It is time we straightened out our national bookkeeping and stopped calling debt what actually is the Nation's expanding credit.

Chairman PATMAN. I am amazed at the amount of information you have given us here. I have looked over your statement, in addition to what you have said about the interest and how it affects the economy; you have a wonderful statement there. All through your statement you have good suggestions and points to consider.

Of course, as you are aware, Mr. Voorhis, this statement will be printed in full and all the Members of Congress will receive a copy, and it goes to all the libraries of the country. It will receive the notice and attention I believe that it deserves.

I know it will be helpful in the thinking of the people because they are studying our monetary system today more than they ever have in the past.

Only yesterday Mr. Martin was here, the Chairman of the Federal Reserve Board, and he made the statement that the 4¼-percent limit on Federal interest rates might have to be thrown aside. We have been watching that carefully. That was put on in 1918, under President Woodrow Wilson. Efforts have been made to take the ceiling off but by organizations which you have been in in the past when you were in Congress. We have succeeded in convincing the leadership that it would be a mistake and they abandoned it each time but now they are up at the ceiling.

The Government bonds are selling at 4.24. We are organizing another committee right now in the House for the purpose of being on the alert to prevent any attempt to increase the ceiling on the 4¼-percent bonds.

We have lived 45 years under that ceiling and we have done quite well under it and there is no reason now why we should take it off. I questioned Mr. Martin when he said that he would be in favor of

taking it off. I said, would you let the interest rates on Government bonds go to 6 percent. He said he would let the market determine that; but the market on Government bonds is a fixed market, of course.

It is fixed. You see, the exclusive dealers in New York have something to do with that. They are all on the same telephone line when they talk, just like a country telephone. And they don't have many secrets. So, it is not much of a competitive market in the Government bond market. The people don't get a very good deal that way. Mr. Martin said yesterday, which I would like you to comment on; I don't want to take up too much time because other members want to ask you a question, but he made an astounding statement yesterday.

It has been hinted all the time that the word independent Federal Reserve means separate, away from the Government. Mr. Dillon always added a phrase to this "independence" of the Federal Reserve by saying that it was independent within the Government. But Mr. Martin and his group claim that they are independent of Government.

In the questioning yesterday, he made it very plain that if there is a conflict between the President of the United States and Mr. Martin and the Board, that Mr. Martin and the Board would prevail. In other words, he is stepping in under our Constitution which says that the Congress shall make the laws. He is stepping in and asking the President to move out of his chair as President of the United States. "I will sit down in that chair on monetary matters," he says, "and pass on them; you don't have any right to do that."

To me that is going rather far.

Mr. VOORHIS. Especially, Mr. Chairman, if the Federal Reserve takes to itself, which it does, the power to issue the money of the country. Either it should not have a right to exercise that sovereign power or else it has got to recognize itself as a public body.

Chairman PATMAN. That is right.

Mr. VOORHIS. Just exactly as your legislation would make it do.

Chairman PATMAN. Yes, sir. You know, the theory is that it is all right for Congress, under the Constitution, to declare war. And, it is all right to draft the young men of the country into war, let them go to battle and die, if necessary, for their country. It is all right to leave in charge of the politicians, the nuclear bombs and the entire national defense. It is all right to have no presidents of railroads on the Interstate Commerce Commission to fix freight rates. It is all right to have no broadcasters on FCC or any airplane companies on the CAB.

It is all right for the Members of Congress to vote on, and have something to do with, everything except money. But money, they say, is something that is sacred, that only a private autocracy should be allowed to handle that.

Mr. VOORHIS. Yes.

Chairman PATMAN. The first thing you know, if this is allowed to continue, we will have a 6-percent interest rate on the public debt. Bankers make their money on debt paper and they want more and more debt paper all the time. Soon we will have a $600 billion national debt and with a 6-percent interest, the interest charges will be $36 billion a year. If that ever happens, then all the taxes we collect will go to pay interest on the Government obligations and we won't have any money for poverty drives or for social security or for anything

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else. We have some people in our country who would be happy with that situation I think, but I don't think it is in the interest of the Nation. Would you like to comment on that?

Mr. VOORHIS. I would, Mr. Chairman. Actually the money should be a reflection of its productivity and its productivity capacity. It should be a neutral element. It should not control or restrict but it should be in supply coordinated with production. It should be a sovereign right of the Nation to control and to issue it, in my judgment.

Chairman PATMAN. If the members will excuse me, we should hear Mr. Keyserling next. I won't take up any more time now. I will yield to Senator Miller or whoever is next after Mr. Keyserling testifies.

Our last witness this morning is Mr. Leon Keyserling, a former Chairman of the Council of Economic Advisers and founder and president of the Conference on Economic Progress. Mr. Keyserling is a graduate of Columbia and Harvard Universities and is a member of the New York and District of Columbia Bars and with a long career in Government, including 4 years as Vice Chairman of the Council of Economic Advisers and 3 years as Chairman.

He is the author of many articles and studies on full employment, economic stability, and related matters. In 1944 he won the $10,000 second prize in the Pabst Postwar Employment Award. Mr. Keyserling, we are pleased to welcome you back before the committee.

We have had you here several times. We have always benefited from your testimony. I know we will find your testimony today very challenging. I understand you have a prepared statement and you may proceed with it, after which we will have a period of questioning under the usual rules. Questions will be both to Mr. Keyserling and to Mr. Voorhis. Mr. Keyserling, please.

STATEMENT OF LEON H. KEYSERLING, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, AND PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS

Mr. KEYSERLING. Mr. Chairman and members of the committee, I would like permission to have my prepared statement inserted in the record, along with certain supporting charts, because I could not possibly cover it orally in the time allotted to me here today.

Chairman PATMAN. Without objection it is so ordered.

(The statement referred to follows:)

PREPARED STATEMENT OF LEON H. KEYSERLING, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS

INTRODUCTION [1]

Mr. Chairman and members of the committee, I appreciate greatly this opportunity to appear before you once again. I shall confine my comments almost entirely to the annual report of the Council of Economic Advisers, rather than to the Econmic Report of the President. I regard the President's Economic Report as evidencing his unalterable determination to make the American economy stronger and more just. Along with most others, I applaud the President's purposes, and believe that he is gifted with all the qualities which a President needs to translate his purposes into ultimate reality. But in the very nature of things, and within the framework of the Employment Act, this President—or any President—must rely heavily upon the analysis and advice of his Council of Economic Advisers. And I believe that this year, despite high capabilities and good intentions, the annual report of the Council of Economic Advisers suffers from some

[1] Numbered charts referred to throughout this statement appear at end of statement, beginning p. 104.

serious weaknesses in economic analysis and policy conclusions. More important still, and I say so more in sorrow than in anger, I submit that this report ignores in primary respects the explicit mandate of the Employment Act of 1946. While it forecasts the economic outlook for 1965 and later years, it fails in the main to define the requirements for maximum employment, production, and purchasing power. Without this definition by way of perspective, the policies which emerge are not adequate policies. I have high respect for the members of the Council. I appreciate my opportunities for friendly relationships with them. But I believe that I can be most useful by stating my views with candor.

I have noted that some of my friends among the economists who have preceded me at these hearings have given assurances of their friendliness to the current administration. Critical to a degree, they insist that they are friendly critics. I do not think that I need to indulge in long protestations of my friendliness to this administration. My record speaks for itself, and its relevance on this point really runs back over 32 years, from when I first entered the Federal service in early 1933. But I have felt all along that I could serve best by speaking frankly, and it is now too late to change my course.

HIGH UNEMPLOYMENT, THE HUGE PRODUCTION GAP, AND THEIR CONSEQUENCES

The Report of the Council of Economic Advisers persists in stating the volume of unemployment as being in the neighborhood of 5 percent of the civilian labor force. But I have not found economists prepared to defend this figure. Taking into account not only full-time unemployment as officially recorded, but also the full-time equivalent of the part-time unemployment which is also revealed in Government statistics, and the concealed unemployed which results from those who are not in the civilian labor force only because of the high level of unemployment and the scarcity of job opportunity, my estimate is that the true level of unemployment averaged 6.3 million or 8.3 percent of the civilian labor force in 1964, and 6.2 million or 8.1 percent of the civilian labor force, seasonally adjusted, in fourth quarter 1964. These estimates are set forth on my chart 1.

A number of years ago, before this committee, I began to make the point that the count of unemployment should include the full-time equivalent of part-time unemployment. It is only more recently that other economists have come to assert the validity of this proposition. Three years or so ago, I began to point out, before this committee, that the concealed or hidden unemployment should also be counted. At long last, in its current report, the Council admits categorically (p. 83) that "many who are not currently counted in the labor force would be at work if unemployment were reduced to 4 percent." The President, on page 7 of his report, puts it even more strongly. He says that there are about 1 million "hidden unemployed" who would enter the labor force if the unemployment rate could be brought down just 1 percentage point. For these reasons, and thinking in terms of a full employment environment, rather than just bringing unemployment down by 1 percentage point, I do not feel that there can be serious challenge to my estimate that concealed or hidden unemployment is now in the neighborhood of 1.5 million.

Yet, for all practical purposes of analysis and policy, the Council continues to talk about 5-percent unemployment. I cannot understand why they persist in this.

The lower half of the same chart 1 contains my estimate that the production gap in 1964 was about $82 billion, or about 11.9 percent of maximum production, and was about $87 billion, or 12.4 percent of maximum production, in fourth quarter 1964 (annual rates). In contrast, the Council of Economic Advisers (p. 39) estimates the production gap now at between $25 and $30 billion. But the Council arrives at this estimate by projecting a 3.5-percent annual growth rate from early 1955, as being consistent with our growth potential. I submit that this is grossly in error, for two reasons. First, we were nowhere near optimum resource use in early 1955. And second, for reasons which I shall disclose shortly, the use of a 3.5-percent figure as representing our potential growth rate from year to year is indefensibly low, and does not square with various findings of the Council itself.

My chart 2, which is based upon the difference between our actual economic growth rate and what I estimate to be the optimum economic growth rate in accord with actualization of our potential growth rate, estimates that, for the 11-year period 1953–64 inclusive, we forfeited $590 billion in total national production (measured in 1963 dollars), and 34 million man-years of employment opportunity, in consequence of the inadequate economic growth rate. Even if it were to be argued that my estimates are considerably too high, and I am prepared to defend them, the magnitudes and their persistence present an enormous challenge to economic policy.

THE INADEQUATE GROWTH RATE SINCE 1953, AND ITS CURRENT PERSISTENCE

My chart 3, with which the committee is familiar in its earlier versions, contains in its first sector data which lead me to insist that, in recent years, we have needed an average annual growth rate in the neighborhood of 5 percent to keep our resources reasonably fully employed. But from 1953 through 1964, the annual average was only 3 percent. As shown by the bottom sector of the same chart, which shows the growth rate trends in 12-month periods, the last 12-month period shown, ending with fourth quarter 1964, reveals a growth rate of only 3.9 percent, representing a sharp shrinkage in the growth rate in each of the 12-month periods following the period from second quarter 1963 to second quarter 1964. And this 3.9-percent growth rate should properly be contrasted, not with the 5 percent or so which we would need subsequent to full economic restoration, but rather with the 8 to 9 percent that we need for at least 2 years to achieve full economic restoration.

Actually, despite all the talk about the longest recovery on record, what has really been stretched out is a period of high level stagnation, and what has really been deferred into the indefinite future is the achievement of anything approximating full economic recovery.

It is striking that even the Council of Economic Advisers, despite the glowing optimism of its report, admits this. For on page 39, the Council says: "The remarkable characteristic of the current expansion is not the degree to which it has carried us toward our objective of full employment. Previous expansions have done as well or better in this respect. Rather, its most remarkable feature is it durability." I do not find much comfort in such long durability of 8 percent unemployment, or even 5-percent unemployment. This is not the purpose of the Employment Act.

THE COUNCIL HAS VIRTUALLY ABANDONED THE CENTRAL PURPOSE OF THE EMPLOYMENT ACT, WHICH IS TO BUDGET MAXIMUM EMPLOYMENT, AND PROPOSE POLICIES ACCORDINGLY

The central purpose of the Employment Act is not to bring forth mere business forecasts, nor to take pride in the fact that previous forecasts have been nearly correct. The central purpose of the Employment Act is to state the requirements for maximum employment, production, and purchasing power, and to devise policies accordingly. This the Council does not even pretend to do.

A simple mathematical demonstration, profoundly important but overlooked in most of the commentaries, should drive this point home. On page 91, the Council say this: "Apart from increases in participation rates that would be induced by improved employment opportunities, the expected annual growth [in the civilian labor force] to 1970 is 1.7 percent, or about 1.4 million persons, a major acceleration from the yearly average of 1.2 percent, or 0.9 million persons, in the past 9 years." (On p. 61, the Council estimates the average annual increase in the civilian labor force through 1970 at 1.5 million.)

Then (p. 54), the Council says that productivity in the private economy advanced during the 4 years 1961–64 at an average annual rate of 3.5 percent. To this the Council adds (p. 83) that "productivity would be higher in a full-employment economy than it is today * * * in periods of underutilization, output per worker is depressed." Thus, the Council now admits a main point which I have been stressing all along.

Adding the 1.7 percent to the 3.5 percent, even without allowing for compounding, and even without allowing for the more rapid growth in productivity and in the civilian labor force which the Council itself says would result under conditions of full utilization, the resultant figure is 5.2 percent. This squares precisely with my own estimates, frequently reiterated, that the growth rate in our output potential is now in excess of 5 percent, and that consequently we must actually grow more than 5 percent a year merely to hold our own with respect to unemployment. This seems well supported by recent developments, especially when full account is taken of the extent to which the true trends in productivity and in the labor force have been concealed by underutilization.

Yet the Council, which until this year was arguing that our growth potential was about 3½ percent a year now says (p. 81) that it is about 3¾ percent a year. How the Council gets 3¾ percent by adding 1.7 percent and 3.5 percent is beyond me, unless the Council takes as our productivity growth potential the average of the last 40 years instead of the average of the last 4 years—a mani-

festly unsound approach, especially in view of the new technology and automation.

This entirely insupportable figure of 3¾ percent apparently explains the Council's optimism in the face of its forecast (p. 85) that recommended policies are likely to yield a 1965 GNP about 4½ percent higher than in 1964 in dollar terms, and it appears somewhat less than 4 percent higher in real terms.

Nor is this all. The Council says that the labor force is going to grow by 1.7 percent or 1.4 million a year. But absorption of this growth would take no account of the excess unemployment, which is currently at least 3 million on a true unemployment basis. To get back to maximum employment within 2 years, the growth in job opportunity would need to be about 3 million a year (counting both the growth in the labor force and the current excess unemployment). This means that employment would need to expand by more than 4 percent a year. Adding this 4 percent to the 3½ percent annual growth in productivity, we need, even according to the Council's analysis, an annual growth rate in the neighborhood of 7½ percent a year for at least 2 years, if we have any serious intent to make real inroads upon unemployment and to restore maximum employment even by 1967. (My estimate is 8 to 9 percent, because I factor in the effect of faster growth and fuller utilization upon productivity trends.)

This figure of 7½ percent makes even more unacceptable the Council's mere forecast that the economy is likely to grow somewhat less than 4 percent in 1965. In short, the Council admits categorically that, while it expects full-time unemployment in 1965 to be somewhat lower than in 1964 as a whole, it is not willing to forecast that it will be lower than it is now. Thus, the Council says (p. 85): "In constant prices, the increase in output is likely to exceed the growth of potential, reducing the gap moderately." Adding to this the fact that the Council is grossly underestimating the current potential growth rate, it is incontestible that the Council has virtually abandoned any effort to do very much about reducing unemployment, or for that matter, about the production gap. I submit respectfully that this committee should consider placing major emphasis, in its forthcoming report, upon this virtual abandonment of the high purposes of the Employment Act.

DEFECTS IN THE COUNCIL'S ANALYSIS OF RELATIONSHIP WITH THE ECONOMY

Under the section heading "The Anatomy of the Expansion" (pp. 39–60), the Council develops its thesis that what it deems the really very good performance of the economy in the most recent years—a proposition which to me represents extraordinary complacency—has been due to a good balance of forces operating within the economy; that is, what might be called a satisfactory economic equilibrium.

But if there has been any such equilibrium, it has been an equilibrium conducive to very large economic slack, rather than to full resource use. The observations which the Council offers, in support of its thesis of a satisfactory balance within the economy, seem to be very weak and substantially off the mark. For example, the Council makes much of the point that inventories have been held low. This is true, but it merely reflects the improved tools available to business management, with respect to awareness of demand trends, which enable business to adjust production more rapidly than many years ago. Inventories may always be held low, and yet ultimate demand may remain extraordinarily below our productive potentials, which indeed is the case.

The real disequilibrium, or lack of balance in the economy, which has been responsible for the enduring high level of unused resources, is to be found in developments which I have frequently called to the attention of this committee, and which I would like now to bring up to date. The essence of the problem is that investment in expanding the means of production has chronically outrun the ultimate demand composed of private consumer spending and public outlays. Far from the situation being remedied, it seems to me to be tending toward aggravation, and to auger no good for the future.

In summary, my chart 4 shows that, from first quarter 1961, to fourth quarter 1964, investment in plant and equipment rose at an annual rate of 7.8 percent, while consumer outlays plus public outlays for goods and services rose at an annual rate of only 4 percent; from fourth quarter 1963, to fourth quarter 1964, this investment rose 11.8 percent, while ultimate demand rose only 4 percent.

My chart 5 indicates that one of the dominant factors in this relatively overexuberant investment boom has been the superfluity of funds available to corporations, including the extraordinary portion of corporate funds drawn from internal sources, reflecting in part excessive pricing policies, and in part excessively generous tax treatment of corporations.

My chart 6 indicates the extraordinary and relatively excessive upswing of key profits after taxes despite large unused capacities, indicating excessive profit margins, abetted by unduly favorable tax treatment.

As another indication of the redundancy of available funds, my chart 7 shows that, in recent years, profits after taxes have been outrunning even the excessively ebullient investment trends.

Contrasted with the foregoing, my chart 8 contains my estimates with respect to the large and growing deficiencies in consumer outlays—my estimate being that a private consumer outlay deficiency of $59 billion in 1964 accounted for almost three-quarters of the total GNP gap which I estimate at about $82 billion. The report of the Council tends to substantiate my factual findings, even though the Council seems to me not to be responsive to the implications of these findings. The Council says (p. 43) that business-fixed investment expanded at an average annual rate of 8 percent from first quarter 1961, through fourth quarter 1964. This was, obviously, tremendously higher than the expansion rate for the overall economy. The Council admits (p. 52) that cash flow has exceeded fixed investment outlays in every year from 1961 forward. The Council admits (p. 53) that even the inadequate expansion of consumer outlays has been supported by an extraordinarily rapid expansion of consumer debts. Thus, the Council points out that the outstanding nonfinancial debt (excluding the Federal Government) has risen 8½ percent per annum during the past 4 years, contrasted with a 5½-percent rise (current dollars) in GNP. In this connection, I cannot agree with the argument of the Council that a sharp rise in the ratio of outstanding debt income is "perfectly normal." I submit, under all the circumstances, that it has elements of real danger.

My chart 9 depicts the downward trend in Federal outlays, when measured against total national production, and when expressed as Budget outlays per capita in uniform 1963 dollars. I regard this as a highly undesirable trend, on both economic and social grounds, for reasons which will be shortly disclosed.

In summary of this phase of the discussion, I find the Council neglectful of the central factors in the economic disequilibrium, and committed largely to policies tending to accentuate this disequilibrium—especially fiscal and monetary policies, which I shall now discuss.

IS THERE SALVATION IN PERPETUAL TAX REDUCTION?

A large portion of the Council's report is devoted to the proposition that the immense tax reductions in recent years have proved their value beyond question. This refrain is now almost nationwide in its intensity, but I submit that the prevalence of the view does not make it correct. I do not want to belabor my views on the subject of tax reduction, which I have voiced many times before, nor do I want to cry over spilt milk. But it is not too late to try to test realistically the consequences of policies already adopted, when more of the same seems to be in the offing.

I submit again that the tax reductions of 1962 and 1964, having an ultimate annual value in the neighborhood of $13 billion, were grossly maladjusted to the correction of the manifest disequilibriums in the economy. Far too much of the tax reduction went to those who needed it least, far too little went to those who needed it most, and much of the tax reduction would have been far more effective if used instead for increased public outlays.

My chart 10 contains my estimates that about half of the $13 billion tax cuts went to corporate investors and to relatively high-income people, who save large portions of their incomes for investment purposes. I maintain that a large part or almost all of this portion of the tax cuts was wasted, in that it added to investment funds which were already ample or even redundant. Even assuming—contrary to my belief—that most of this portion of the tax cuts added to immediate spending, this tended to increase the fundamental disequilibriums between investment and consumption, and in any event a different distribution of the tax cuts would have been infinitely preferable on social grounds which must enter into responsible national economic policy. My chart 11 shows how unconscionably large proportions of the 1964 tax cuts went to augment the disposable incomes of those at the top of the income structure, which is strangely

inconsistent with our ultimate national needs and with an all-out war against poverty.

There are several valid answers to those who advance the so-called pragmatic answer that the tax cuts "have worked." They certainly have provided some temporary stimuli to the economy. But considering their magnitudes, they have done remarkably little to reduce unemployment. And when those who defend this $13 billion in tax cuts now argue that we may need more of the same before the end of 1965 to keep the boom rolling, I submit that they should consider the propriety of the remedy. For if it takes this much tax cutting to keep the boom rolling, taxes will soon approximate zero, and then where will we be from the viewpoint of the revenues needed to support the programs of the Great Society?

WHY MASSIVE TAX CUTS CANNOT REDUCE UNEMPLOYMENT VERY MUCH

The general theory in back of the tax cuts is that tax reductions increase aggregate demand, and that more aggregate demand means more employment. This completely neglects the fact that the economic disequilibrium results not from total unavailability of adequate purchasing power, but rather from its maldistribution. If this were not the case, we could get full employment by giving another $20 billion of tax reduction to corporations and persons of high income. But they could not invest it, and they would save rather than spend much of it (even if they did spend it for consumption, the social results would be unconscionable, when we have so much poverty and such great national public needs).

The report of the Council of Economic Advisers accepts without question this whole fallacious doctrine of the efficacy of expansion of aggregate purchasing power, regardless of its distribution. Thus, the Council says (p. 98) that further Federal fiscal stimuli will be needed, but that the criteria in choosing between more tax reduction and more public outlays are "not primarily economic."

This bland assumption by the Council that there is not much economic difference between a given volume of tax cuts and the same volume of increased public outlays is utterly insupportable on purely economic grounds, quite aside from the social question. This bland assumption ignores the very nature of the new technology and automation. As shown by my chart 12, the trends in technology and automation, in most basic sectors of the private economy, are such that no feasible increases in demand for their products can result in much additional employment. For example, in the automobile industry, less than 59 workers in 1963 turned out as much as more than 108 turned out in 1947. This means, very simply, that the creation of the 25 to 27 million new jobs which the Government itself says are needed over the next decade will depend upon a pronounced shift in the structure of demand, toward those types of products where the Nation's unmet needs are so great that the increased demand for products can run far ahead of the increases in technology and productivity in these particular sectors. This means relatively more emphasis upon rehousing slum dwellers, rebuilding our cities, improving our mass transportation, developing and replenishing our natural resouces, expanding both facilities and personnel with respect to education and health services, etc. To illustrate these needs, my chart 13 indicates my estimates as to the relative opportunities for employment expansion from now through 1975. Manifestly, this calls for relatively more emphasis upon increased public outlays than upon tax reduction. Moreover, the shift in the product mix thereby obtained would be entirely compatible with the war against poverty and the real needs of the Great Society.

Professor Galbraith, in his recent testimony, argues for more public spending instead of more tax cuts. I agree with his conclusion, but dissent in large part from some of his implications. His argument is that most of the unemployment today is due to the unfitness of the unemployed for available jobs, and that more public spending would help to train and educate them so that they would be fit for these jobs and obtain them. While I agree as to the need for more education and training, all experience indicates that the main problem is to create the jobs. The jobs draw in the people, and they get trained mostly on the job, and in any even we do not know what to train them for until we know what jobs are opening up. Therefore, as against the school which places major emphasis upon the structure of the labor force, I agree that the problem is to create enough aggregate demand to restore full employment. But we cannot get enough aggregate demand without drastic changes in the structure of demand. Viewing

technological factors as well as the Nation's needs, we must get the changes in structure of demand to which I have referred above, in order to move toward full employment. And these changes in the structure of demand cannot possibly be accomplished by more and more tax reduction; they require, for the reasons already stated, vastly increased public outlays. The fact that this shift in public policy would also administer so much better to the needs of the poor and deprived, and to the growing gaps in our public services, illustrates my favorite thesis that the economic problem and the social problem, the employment problem and the poverty problem, are really all one problem in the United States. Fragmentizing them into isolated compartments points us in the wrong direction on all fronts.

The neglect of the problem of the needed shifts in the structure of demand is well illustrated by the Council's treatment of the housing problem. My own estimates indicate that an adequate program of rehousing the one-fifth of the Nation who still live in slums, and corresponding rebuilding of our decaying municipal areas, could during the next decade meet a full half of the whole requirement for net additions to employment. It could simultaneously make the largest single attack upon the problem of poverty, which is so deeply rooted in the slums. It could simultaneously, through the uniquely high "multiplier" effect of housing outlays, contribute most to the maintenance of adequate economic growth.

But due to failure to quantify on a long-range basis the various components in our resources and needs, the Council nowhere identifies the vital importance of the housing problem. Merely qualitative reference to this problem is not enough, without identification of the amounts and types of housing required, and the changes in both public and private economic policies, including fiscal and monetary policies, essential to achieve these goals. As a striking evidence of this oversight, the Council (pp. 48–49) seems entirely complacent about the tapering off of housing starts, and equally complacent about its own forecast (p. 86) that no substantial expansion of housing outlays is expected in 1965.

EXCESSIVE TAX REDUCTION HAS GRAVELY AGGRAVATED THE BALANCE-OF-PAYMENTS PROBLEM

In previous years before this committee, I have urged that huge tax reductions to corporations which already had plenty of funds, and to high-income individuals, would mean that a large part of these tax reductions would be spent overseas, and would thus aggravate our balance-of-payments difficulties. My chart 14 shows exactly how this has come to pass. In 1964, the net outflow of U.S. private capital came to $6 billion, compared with $4.3 billion in 1963, and $3.4 billion in 1962. In the fourth quarter of 1964 our overall unfavorable balance was almost $6 billion at an annual rate, or almost twice as high as for 1964 as a whole. I have not been able to get the internal composition of this unfavorable balance in the fourth quarter, but it is manifest that the serious worsening of the situation was due to a further immense outflow of U.S. private capital. This must be so, because in fourth quarter 1964 our favorable balance with respect to goods and services was at an annual rate of $8.5 billion, contrasted with $8.1 billion for 1964 as a whole.

Roughly speaking, we must assume that a very preponderant portion of the tax reductions received by corporation and high-income individuals resulted merely in the flow of dollars from the United States overseas, so that in effect we have used tax reduction to help finance our unfavorable balance-of-payments position. All this, I repeat, is just as I predicted a year ago. And even while we are doing this, we are engaged in the contradiction of imposing taxes to bring back home some of the money we coaxed to go overseas by incontinent tax reduction.

There are many other reasons why this extraordinary rate of U.S. private investment in highly developed countries overseas is dangerous to us. It is dangerous because it is at a nonsustainable rate, as the countries of Western Europe will come increasingly to resist it, rightly or wrongly. If instead of using tax reduction to augment this outflow of capital, we had used other measures more suited to the domestic expansion of the American economy, we would not only have had a surer foundation for our own future progress, but in addition would have encouraged U.S. capital to stay at home by providing more outlets for sustainable investment at home.

The report of the Council fully admits (p. 72) that "the principal reason [for the unfavorable trends in our balance-of-payments position] has been the relatively large rise in private capital outflows—an element of the balance of

payments which might have been expected to rise less rapidly or oven to decline in a period of rising domestic activity." If the Council had read my previous testimony before this committee on the subject of the balance of payments and the effects which excessive tax reduction would have upon it, they would not have been so surprised by the most recent developments.

THE HIGHLY UNDESIRABLE MONETARY POLICY

The Council (p. 106) is still speaking bravely in support of the prevalent monetary policy, mainly on the ground that increased interest rates, at least of some types, are needed to inhibit the outflow of U.S. private capital, and that consequently we must continue to suffer a monetary policy which represses the rate of our domestic economic growth. Repeatedly before this committee and elsewhere, I have urged that rising interest rates would not in fact inhibit the outflow of U.S. capital, which is seeking profitable investment rather than higher interest rates, and that the damage done to U.S. economic growth by the prevalent monetary policy, and by the disequilibriating aspects of other national economic policies, would, in fact, accentuate the outflow of U.S. private capital. All of this is now coming to pass, but the Council seems not yet ready to admit it.

We have not yet risen to an awareness of how much damage is being done to the U.S. economy by the prevalent monetary policy. As shown by my chart 15, the average annual growth in the nonfederally held money supply from 1953 through 1964 has been only 2 percent. This is a basic explanation of why the average annual growth rate of the U.S. economy, over the same span of time, has been only 3 percent, when it should have been at least 5 percent. While the monetary policy has been somewhat more liberal in the most recent years, it has not yet moved nearly far enough, and it still hangs as a sword of Damocles over our prospects for adequate economic growth.

Quite aside from this, and even more important, as shown by my chart 16, the rising interest rates, which are an essential element in the prevalent monetary policies, transferred more than $50 billion in a highly regressive direction during the period from 1953 through 1963. The relevance of this is manifest in terms of my thesis that the maldistribution of income has been at the heart of our economic troubles. My charts 17 and 18 contain my estimates of how a continuation of the prevalent monetary policy would impose charges upon the Federal budget which might so much more profitably be used for other purposes, and how these excessive interest costs detract from resources available for the war against poverty and bear down upon the average American family.

THE FUNDAMENTAL PROBLEM OF INCOME DISTRIBUTION

My core concern about the report of the Council of Economic Advisers is that it really overlooks or skirts what seem to me to be the big and difficult problems of our economy. As I have indicated, these problems raise the question of the attainment and maintenance of economic equilibrium at maximum resource use. This issue, in turn, is fundamentally one of income distribution. It is income distribution that allocates resources. And in a country as highly developed as ours in a material and technological sense, it is the allocation of resources which determines how close we come to full resource use.

It is by now apparent that my analysis leads to the conclusion that we are chronically plagued by the problem of excessively slack resources, mainly because of faulty income distribution, compounded by national economic policies which have in part contributed to this faulty distribution and in any event failed to make appropriate efforts, within the ambit of our institutions and ideals, to help correct this maldistribution.

I, therefore, find it desirable to bring before this committee a few outstanding illustrations of this distributional problem, especially as they are areas of concern to me, but to which the Council's report pays little or no attention. I deplore the recent tendency of so many outstanding economists to shun the whole problem of income distribution, possibly on the ground that it is a thorny and controversial subject, when it is a problem at the very heart of our economic and social performance.

(1) My chart 19 indicates that, as of 1962, the top quintile of all U.S. multiple-person families had more than eight times as much more income as the lowest quintile, and very considerably more than the lowest three income quintiles. With respect to unattached individuals, the top quintile had more than 26

times as much income as the lowest quintile, and considerably more income than the 4 other quintiles put together. I do not regard this pattern of income distribution as conducive to optimum economic performance, and it is certainly not compatible with our social conscience when more than 34 million Americans live in poverty, and when about twice this number live either in poverty or deprivation.

(2) Another very important illustration of income maldistribution, which impacts very adversely upon our economic performance, relates to farm income. My chart 20 shows that, during 1953–64, net farm operators' income declined at an average annual rate of 1.4 percent, while total nonfarm income increased at an average annual rate of 3.6 percent. My chart 21 contains my estimate that, since 1953, and on into 1964, the deficencies in farm income from all sources has been in the neighborhood of one-fifth of the deficiency in total U.S. personal income—and this latter deficiency has been basically responsible for the inadequate overall economic performance. And my chart 22 contains my estimate that the cumulative withdrawal from the farm labor force since 1953 was equal by 1964 to more than 47 percent of the true level of U.S. unemployment, and equal to more than 90 percent of excess unemployment. Allowing for a variety of factors of adjustment, my estimate is that at least a third, and probably considerably more, of the excess U.S. unemployment today is due to the economic conditions which have forced farmers off the land and into industrial areas. I am very much surprised that the Council does not pay more attention to the problem of agricultural restoration, as a key factor in the restoration of the U.S. economy at large, to maximum economic performance.

(3) The Council's treatment of the wage problem seems to be another example of its failure to probe the problem of economic equilibrium, as it hinges upon income distribution. As wages are both a business cost and a dominant factor in consumer incomes and spending, I become increasingly concerned each year that the Council focuses its attention excessively upon avoiding wage increases which are too high from the viewpoint of business costs, and ignores entirely the problem of whether wages are too low from the viewpoint of consumer purchasing power. This one-sided treatment seems to me particularly deplorable, when all quantitative analysis seems clearly to support the proposition that, all proper things considered, income flowing to investors has been disproportionately large in comparison with income flowing to consumers, and particularly middle- and low-income consumers.

The Council (pp. 54–55) argues that there has been a "healthy balance" among wages, prices, and productivity trends. This argument seems to be faulty in a variety of ways. First, in view of the increasing productivity of capital, it may be that wage earner gains somewhat exceeding productivity gains may be needed for a while to restore economic equilibrium. More important, the Council compares a 3.5 percent average annual increase in productivity, during the years 1961–64, with a 3.6 percent average annual increase in straight hourly earnings plus fringe benefits. Fringe benefits at the expense of gains in straight average hourly earnings tend to induce oversaving relative to immediate spending. From the viewpoint of equilibrium analysis in the context of our current economic problems, it is more important to compare productive trends with trends in straight average hourly earnings, and the Council's own figures show that during the past 4 years the average annual increase in straight hourly earnings has been only 2.6 percent, a very serious lag behind the 3.5 percent average annual increase in productivity. This becomes more serious, both as an economic factor and as an exacerbating factor, when sufficient attention is paid to the excessively high profit margins to which I have already referred. Highly relevant in this connection is my chart 23, which depicts from 1957 through 1964 the very serious lag in wage-rate trends behind productivity trends in the private economy at large, in manufacturing, and in such key industries as iron and steel and railroads.

In any event, the Council's wage guidelines, which would hold wage-rate increases in the most productive and profitable industries to the average rate of productivity gains for the economy as a whole, are economically unsound and unworkable. If adhered to, they would obviously mean that wage-rate gains for the economy as a whole would be far below productivity gains for the economy as a whole, in that wage-rate gains in the less productive and profitable industries would necessarily be much lower than whatever the wage-rate gains might be in the most productive and profitable industries. A universal guideline for wage-rate gains, unaccompanied by any universal standards for profits or

profit margins, and unaccompanied by any tax policy designed to drain off excessive profits and reallocate resources to the war against poverty and the great priorities of our national public needs, is seriously defective and unbalanced on its face.

Finally, in this connection, instead of talking only about a "balance" between wage and price trends, the Council should consider wage-profit relationships, which are far more relevant. They have ultimate bearing upon the relationship between investment and consumption.

(4) Still another example of income maldistribution which works against economic equilibrium, quite apart from its social and human implications, is the unduly small portion of our total national income and output which is being allocated through public policies to our senior citizens. My chart 24 indicates that approximately three-fifths of all OASKI beneficiaries, aged 65 and over, live in poverty. My chart 25 indicates that far more than four-fifths of all those receiving public assistance, aged 65 and over, who do not receive OASKI benefits, live in poverty. Any effort to restore economic equilibrium at full resource use, by bringing consumption more into line with our burgeoning productive powers, and any fully implemented war against poverty, would start with massive measures directed toward huge increases in both insurance payments and pension payments to the aged.

The Council cites as a plus factor for 1965 the increased payments which will occur under the social security program. But it does not attach sufficient weight to the regressive effects of the increased payroll taxes which will go into effect in 1966. How much better off we would all be, both economically and socially, if the endless billions of dollars which we seem to be pouring into tax reductions, and largely for the wrong recipients, were instead used in part to make Federal contributions, financed out of progressive taxation, to lift millions of our senior citizens out of the poverty cellar.

THE COUNCIL IS NOT ADEQUATELY BUDGETING OUR RESOURCES AND NEEDS

The whole import of what I am saying is that, contrary to the express intention of the Employment Act, the Council is not making long-range quantifications of our needs and resources, as guidelines to economic policy. If it would do so, the whole context of policy would undergo drastic change, as it would at once become apparent from these long-range quantifications that recent and current trends in policies are not suitably adjusted to our economic purposes and goals.

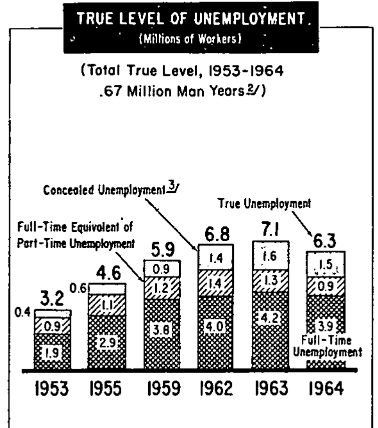
In view of the inexplicable reluctance of the Council to engage in this essential undertaking, it seems to me doubly important that this committee, building upon such useful work which it has already done, would be well advised to push further these types of undertakings. I also believe that the committee, in its forthcoming report, should insistently request that the Council adhere more closely to the beneficial methodology set forth in the Employment Act itself.

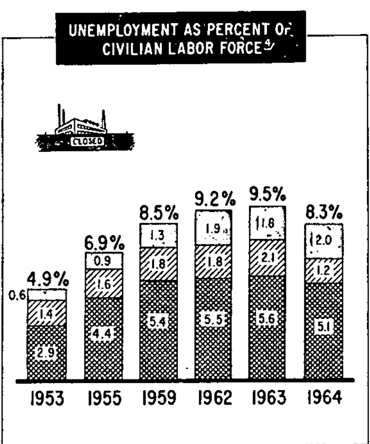
Merely by way of suggestion, I am concluding my testimony with reference to a few charts which set forth my own estimates of our needs and resources. On chart 13 to which I have already referred, I set forth my estimates of viable patterns of employment growth. Chart 26 is an effort on my part to quantify the importance of our attaining and maintaining an adequate rate of economic growth in the years ahead through 1970. Chart 27 sets forth my estimates for needed increases, through 1970 and 1975, in employment, production, and various types of private and public incomes and outlays. And chart 28 indicates, by way of example, how far we can move toward liquidation of poverty in the United States by 1970 and 1975, if we use our resources fully and wisely. And charts 29 and 30 indicate the appropriate role of the Federal budget in balanced efforts toward optimum economic progress.

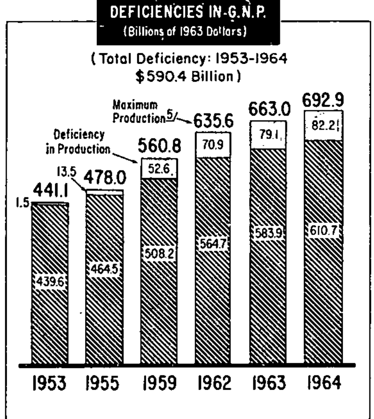
Whether or not one agrees entirely with these quantifications, my main point is that they represent the type of exercises to which the Council must turn its attention, and upon which it must increasingly focus the attention of the country, if the purposes of the Employment Act and the goals of the Great Society are to be vigorously and effectively pursued.

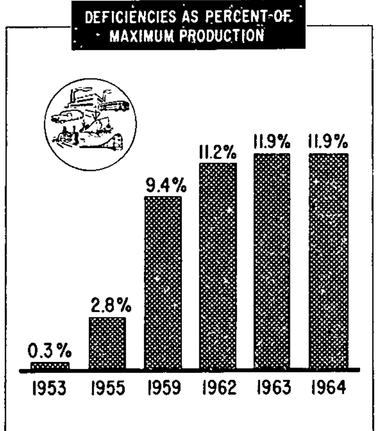
CHART 1

CHRONIC RISE OF UNEMPLOYMENT AND OF IDLE PLANT, 1953-1964[1]









[1] Except for the base year 1953, no year during which a recession was in process is included.

[2] About 33 million man-years of unemployment (true level) would have been consistent with maximum employment.

[3] Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

[4] In deriving these percentages, the civilian labor force is estimated as the officially reported civilian labor force plus concealed unemployment.

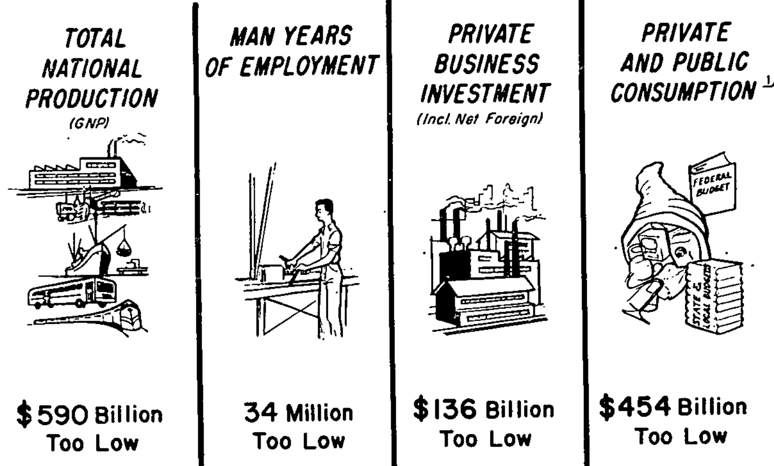
[5] Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

Note: In 4th Quarter 1964, seasonally adjusted, True Unemployment was 6.2 million workers, or 8.1% of the Civilian Labor Force; the GNP deficiency was $87.2 billion, or 12.4% of maximum production.

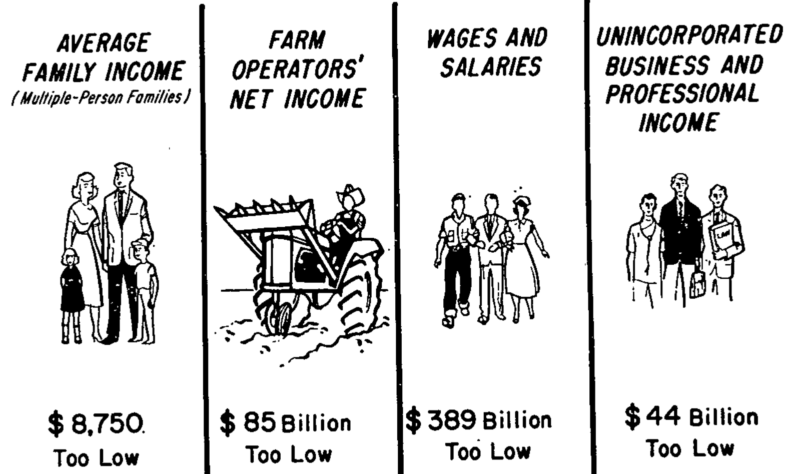
CHART 2

LARGE NATIONAL ECONOMIC DEFICITS DURING PERIOD 1953-1964

Dollar Items in 1963 Dollars



. . . THESE HAVE LED TO LARGE LOSSES TO ALL ECONOMIC GROUPS

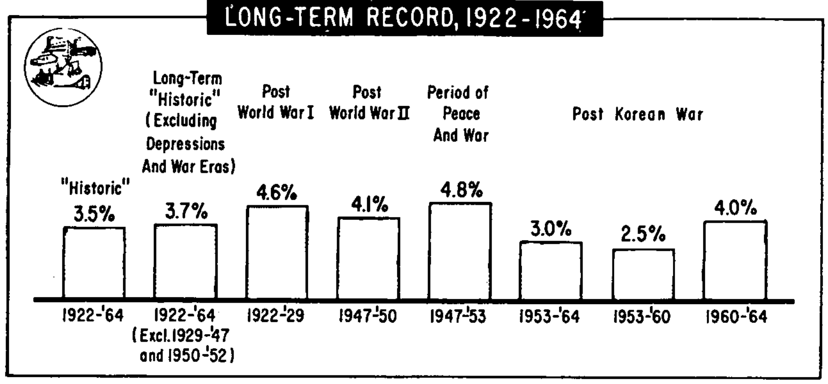


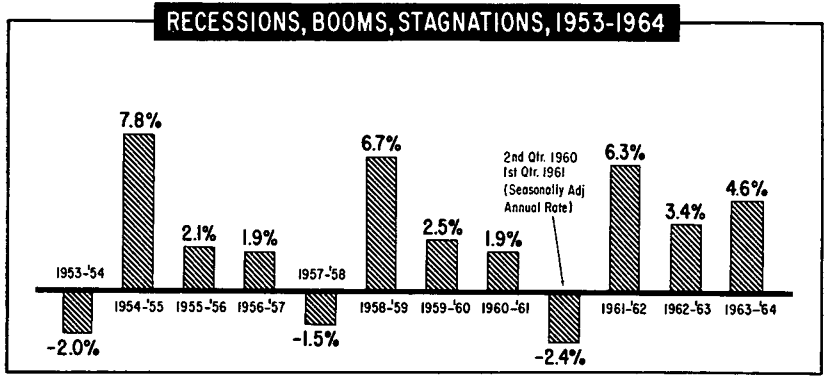
1/ Includes personal consumption expenditures plus government (Federal, state, and local) expenditures ($ 392. and $62 billion, respectively)

CHART 3

GROWTH RATES, U.S. ECONOMY, 1922-1964

Average Annual Rates Of Change In Gross National Product
In Uniform 1963 Dollars





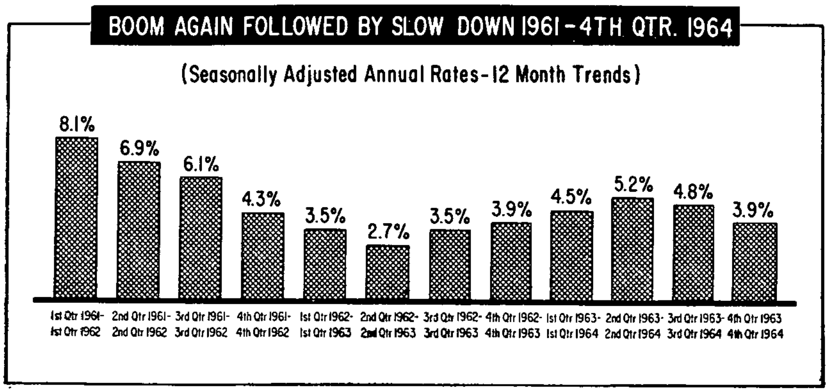
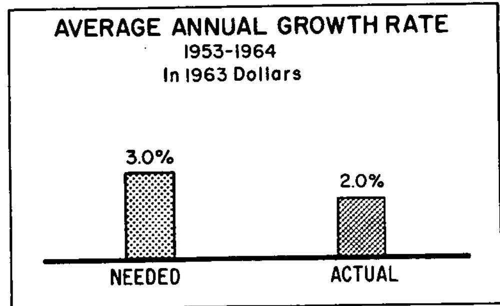
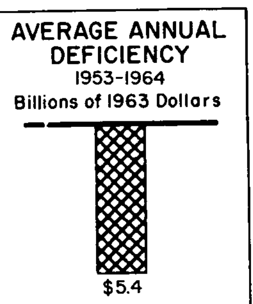


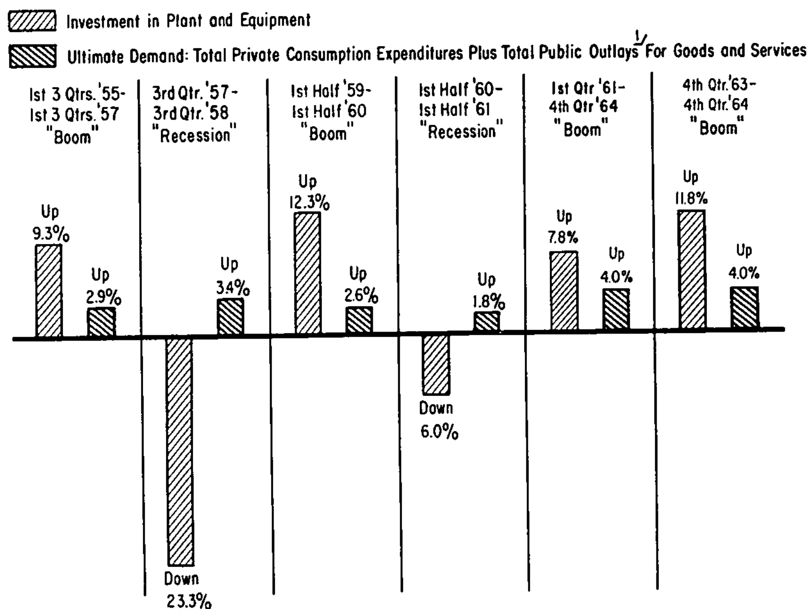
CHART 4

INVESTMENT IN PLANT AND EQUIPMENT WAS DEFICIENT – 1953 – 1964 AS A WHOLE





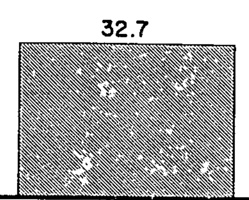
BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS

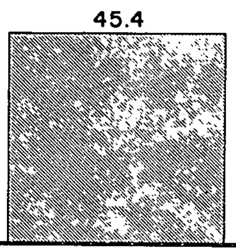


AVERAGE ANNUAL RATES OF CHANGE
in 1963 Dollars

[1] Federal, State and local.

CHART 5

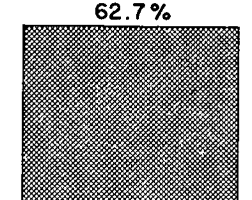


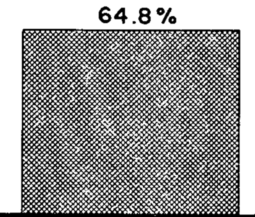


1947-1953[1] Annual Average

1953-1964[2] Annual Average

PORTION OF THESE FUNDS USED FOR PLANT AND EQUIPMENT HAS GROWN

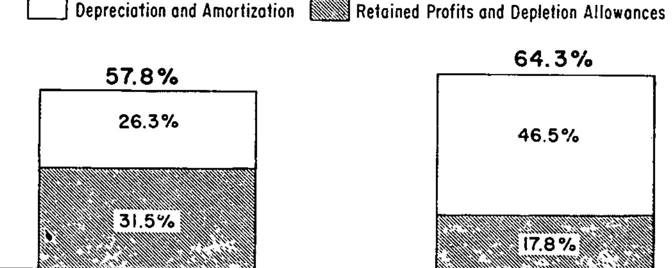




1947-1953 Annual Average

1953-1964 Annual Average

PORTION OF CORPORATE FUNDS DRAWN FROM INTERNAL SOURCES HAS RISEN



1947-1953 Annual Average

1953-1964 Annual Average

[1] 1947-1953 data adjusted for comparability with revised series for 1953-1964.

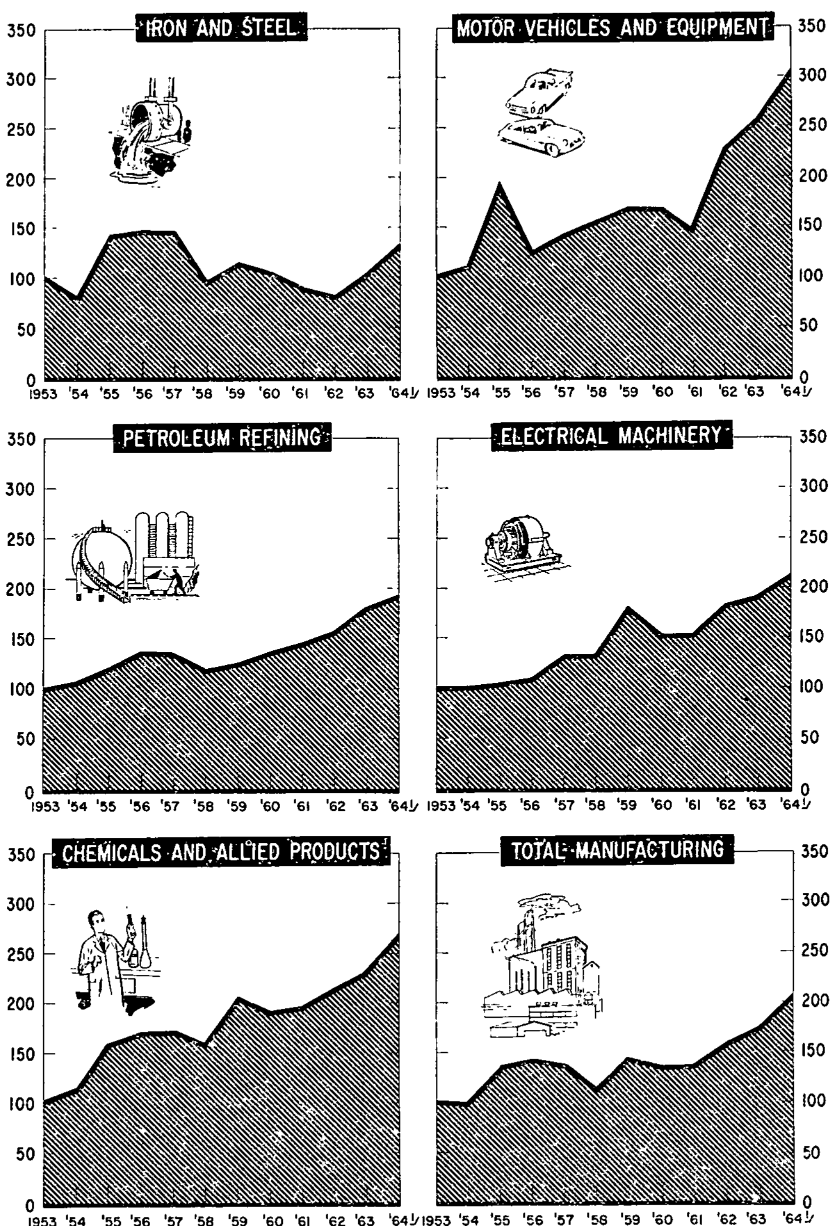
[2] 1964 data in each case are preliminary estimates.

Data: Dept. of Commerce.

Chart 6

KEY PROFITS AFTER TAXES ARE HIGH DESPITE LARGE UNUSED CAPACITIES

1953=100



1/ 1964 estimated on basis of first three quarters.

CHART 7

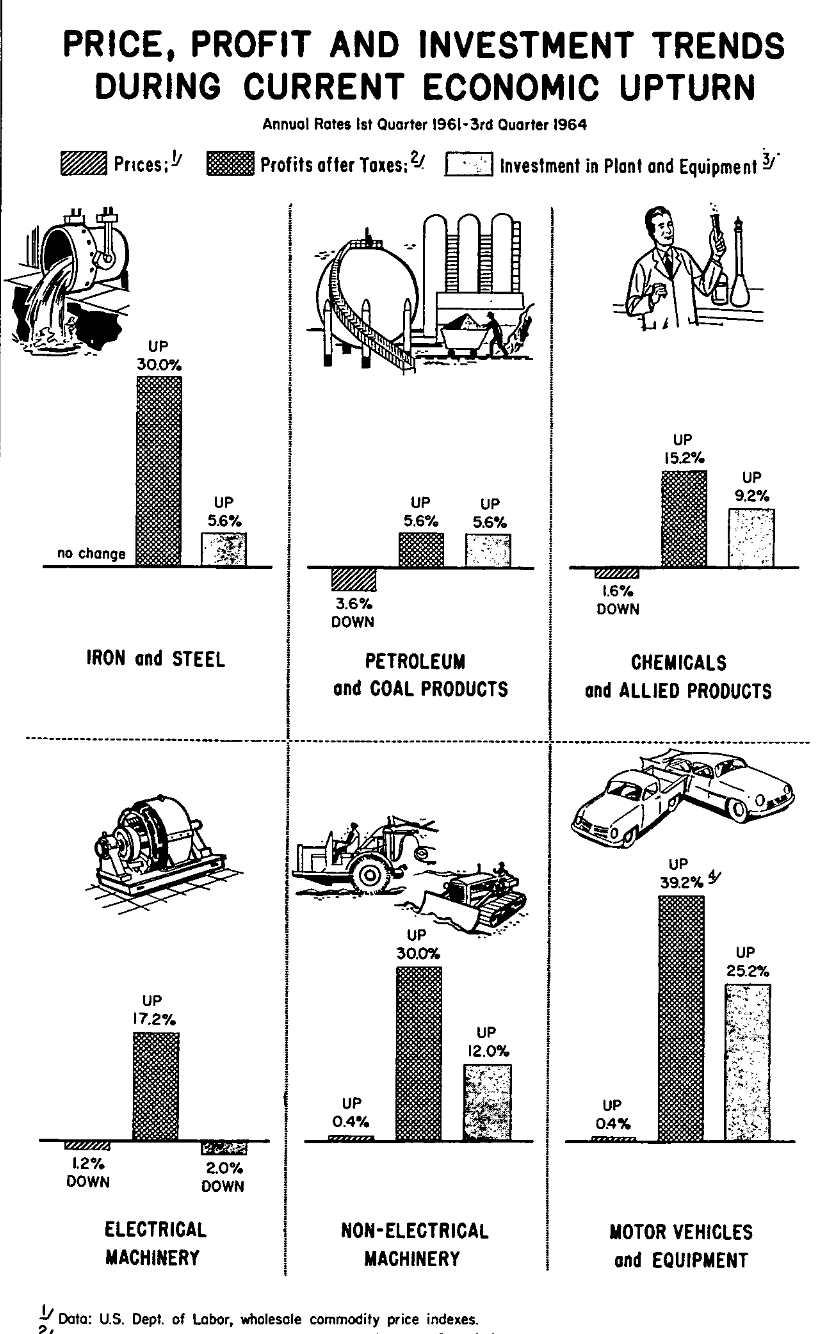
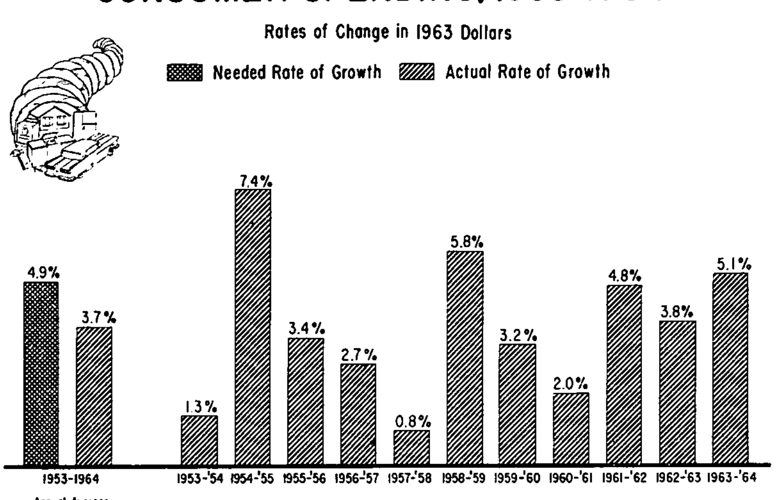


CHART 8

DEFICIENT RATE OF GROWTH IN PRIVATE CONSUMER SPENDING, 1953-1964



THE PRIVATE CONSUMPTION DEFICITS DOMINATE THE DEFICITS IN THE TOTAL ECONOMY

Billions of 1963 Dollars

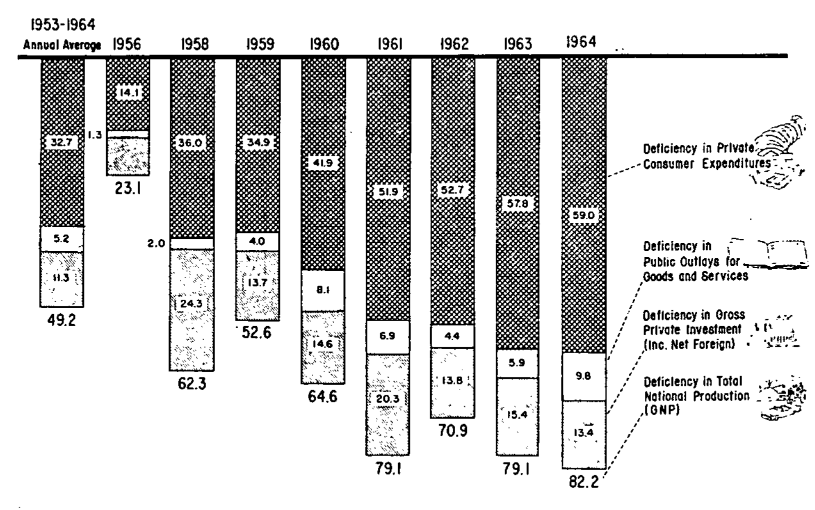
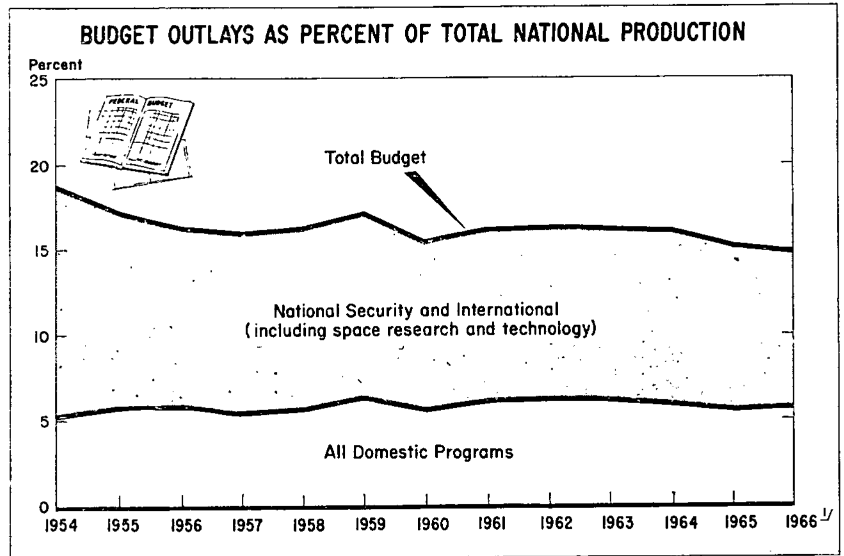
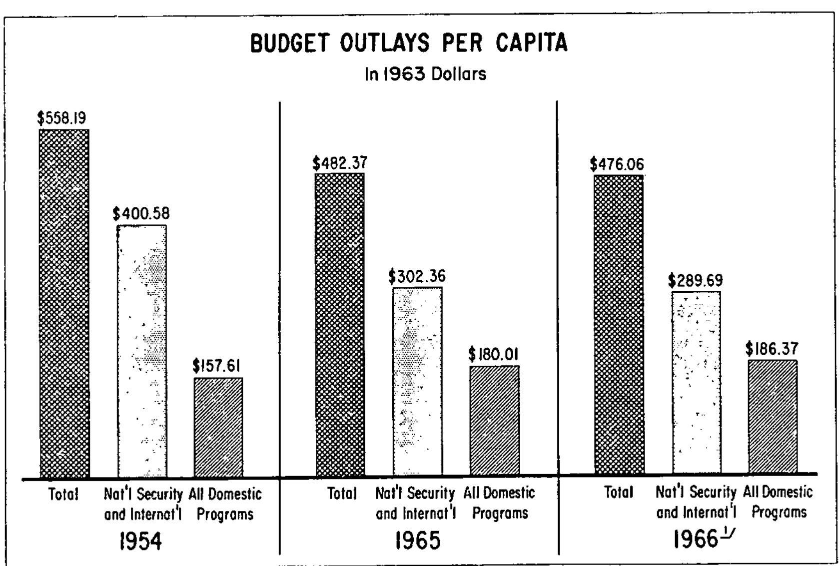


CHART 9

FEDERAL BUDGET HAS SHRUNK RELATIVE TO SIZE OF ECONOMY AND NEEDS, 1954-'66

Fiscal Years





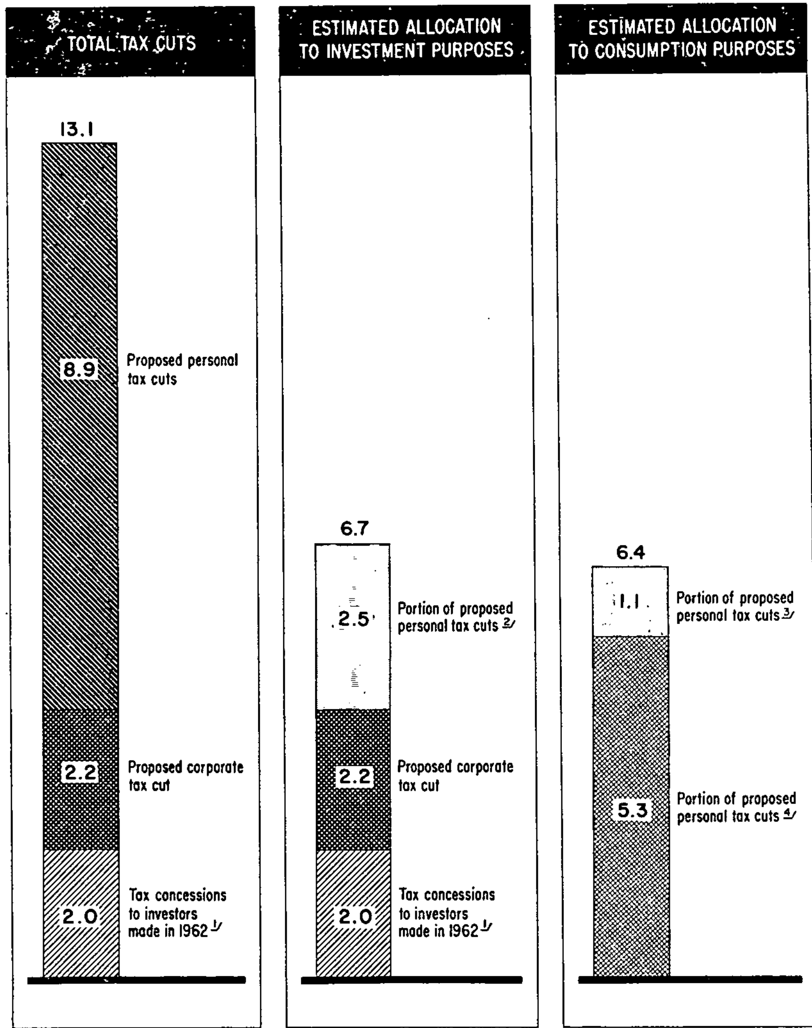
1/ Administration's proposed Budget as of Jan. 25, 1965; G.N.P estimated at $675.0 billion, CEP.

CHART 10

1962 and 1964 TAX CUTS: ESTIMATED DIVISION BETWEEN CUTS FOR INVESTMENT PURPOSES AND CUTS FOR CONSUMPTION PURPOSES

(Including-Tax Cuts of 1962)

Billions of Dollars



1/ Through Congressional and Executive action.

2/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would save for investment purposes.

3/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would spend for consumption.

4/ Personal tax cuts for those with incomes under $10,000.

Note: Estimates of division, CEP.

CHART 11

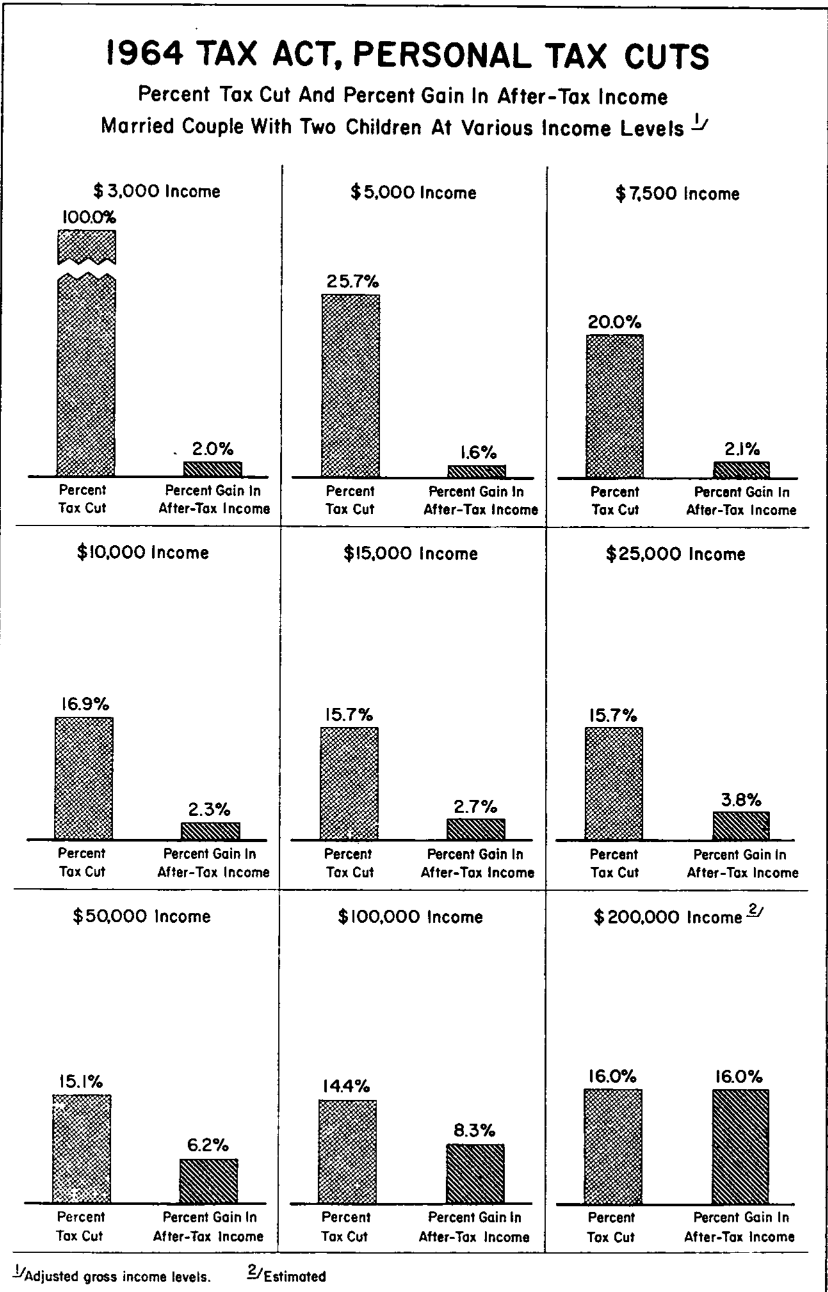


CHART 12

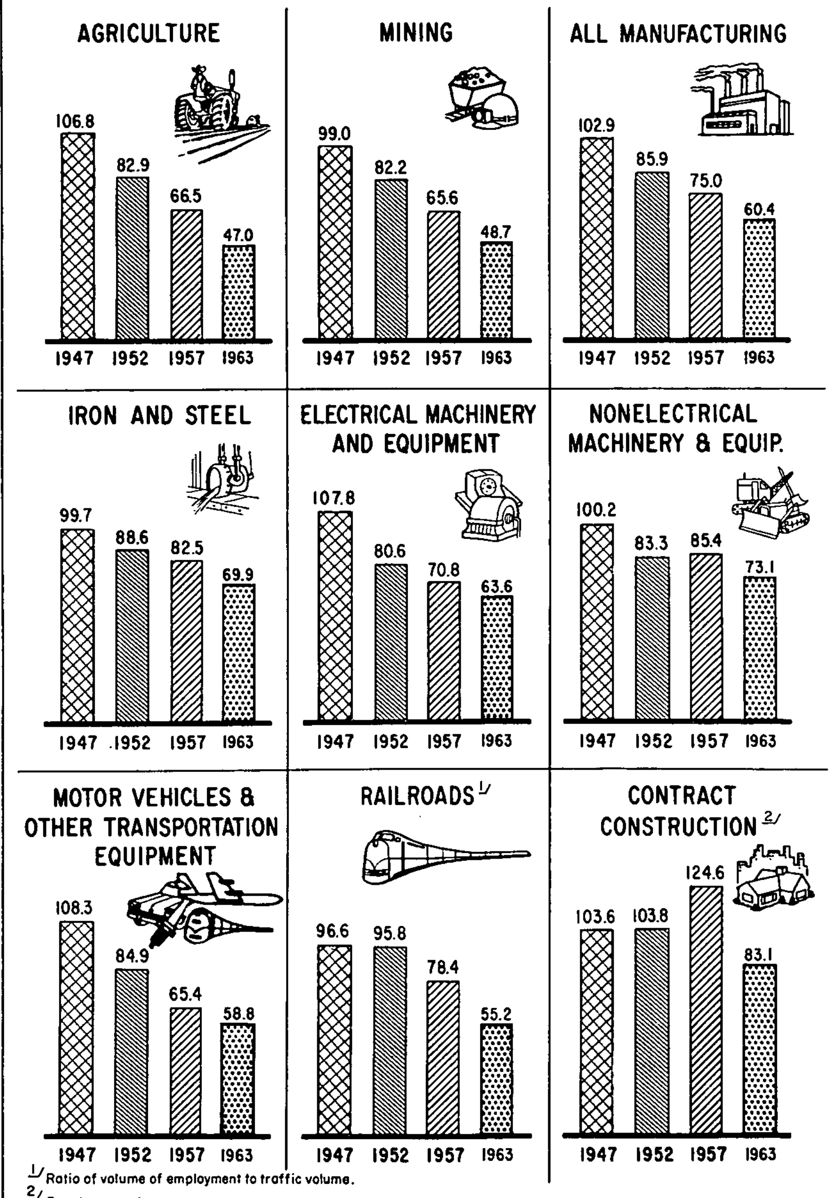


CHART 13

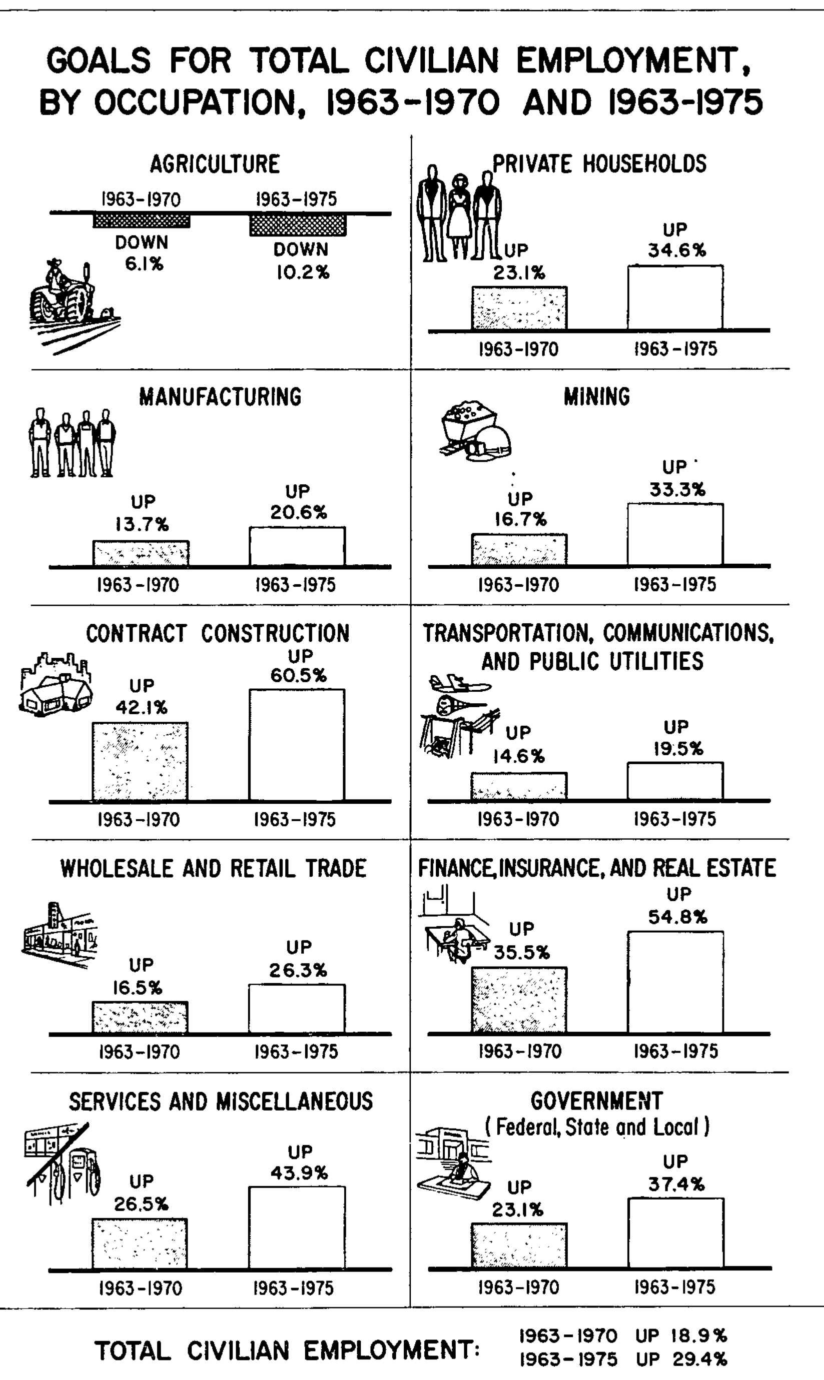
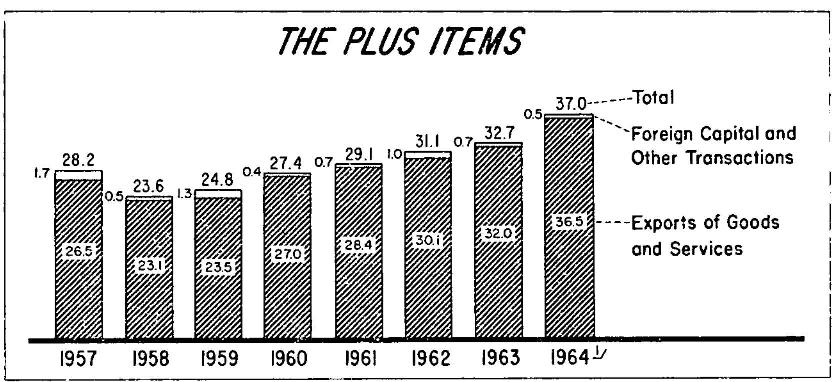
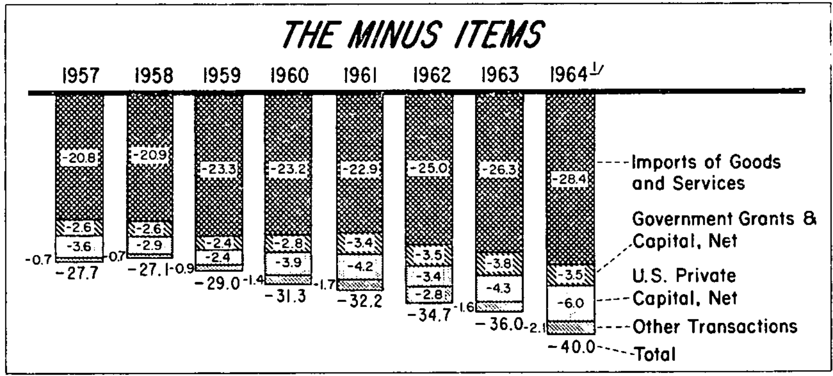


CHART 14

U.S. BALANCE OF PAYMENTS, 1957-1964[1]

Billions of Dollars





THE OVERALL BALANCE

+0.5 1957

1958 -3.5

1959 -4.2

1960 -3.9

1961 -3.1

1962 -3.6

1963 -3.3

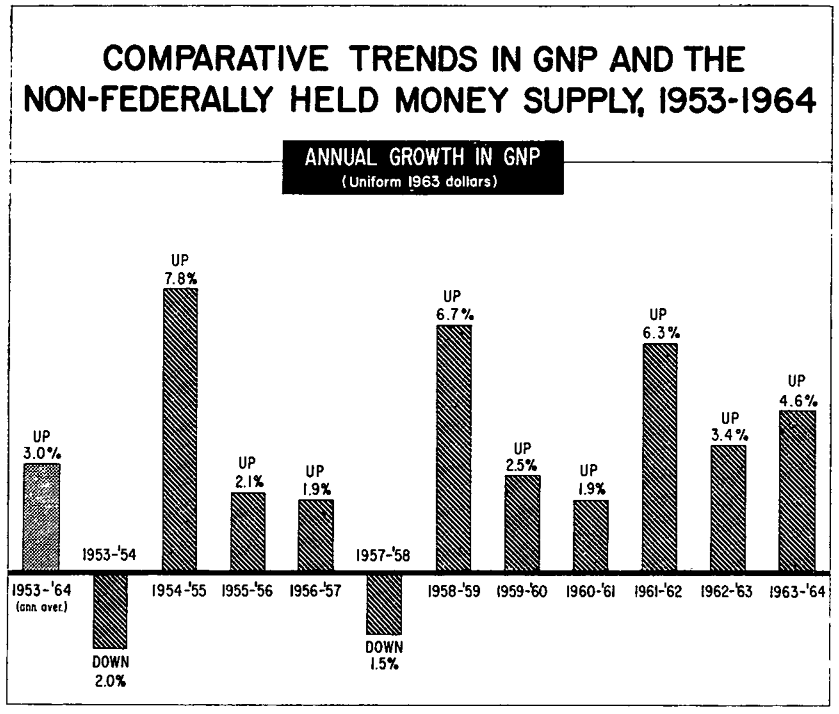
1964[1] -3.0

[1] Preliminary

Note: In 4th Quarter 1964, the overall unfavorable balance was $5.8 billion, although the favorable balance on goods and services was $8.5 billion (seasonally adjusted annual rates).

Source: Dept. of Commerce

CHART 15



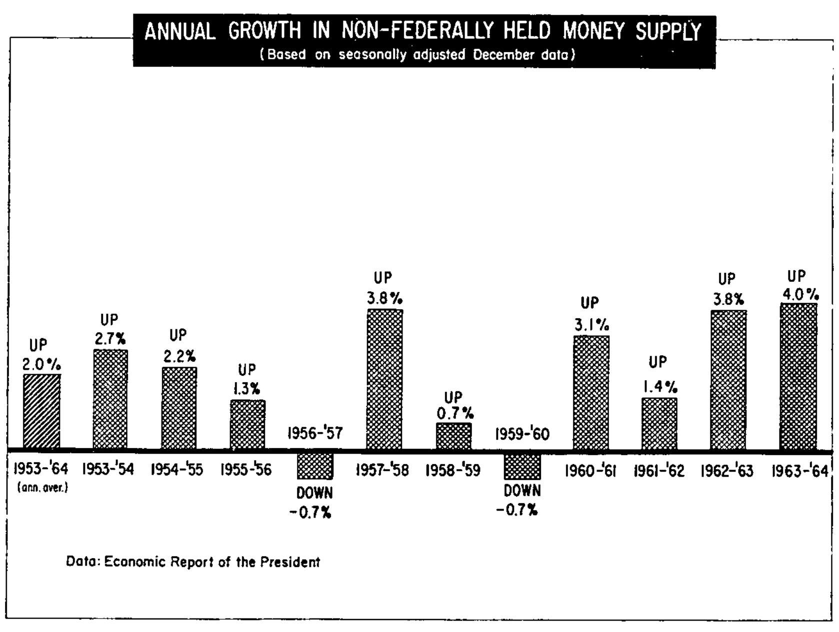
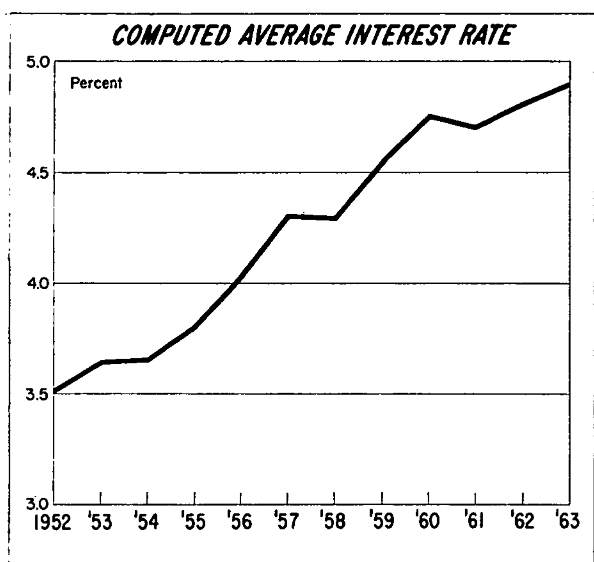
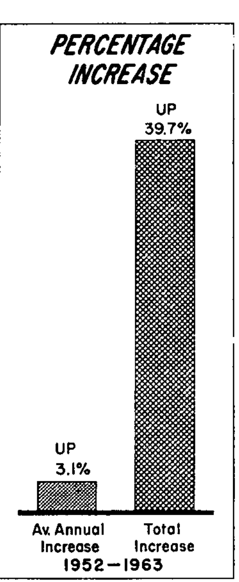


CHART 16

AVERAGE INTEREST RATES ON TOTAL PUBLIC AND PRIVATE DEBT, 1952-1963

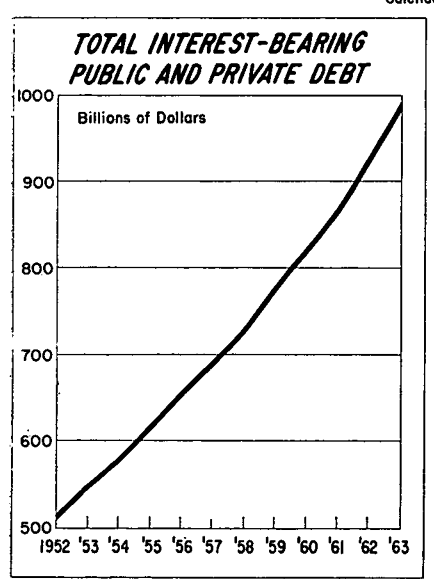
Calendar Years

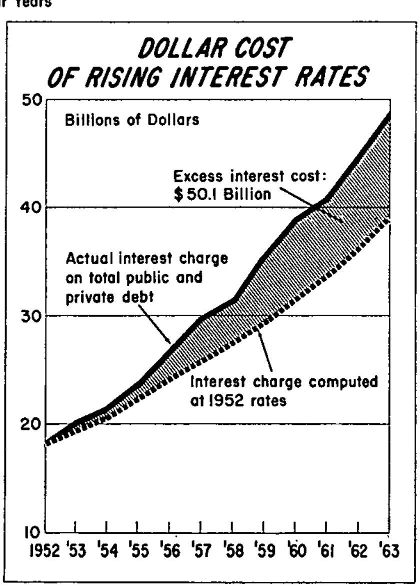




TOTAL PUBLIC AND PRIVATE COST OF RISING INTEREST RATES, 1953-1963

Calendar Years





Data: U.S. Treasury and Office of Business Economics, Department of Commerce.

CHART 17

ESTIMATED EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1964-1970 CONTRASTED WITH OTHER COSTS RELEVANT TO THE WAR AGAINST POVERTY*

Millions of Dollars

EXCESS INTEREST COSTS IN THE FEDERAL BUDGET

$3,149 — 1963

$3,895 — Annual Average 1964-70

BUDGET OUTLAYS FOR EDUCATION

$1,691 — 1965

BUDGET OUTLAYS FOR HEALTH SERVICES AND RESEARCH

$1,733 — 1965

BUDGET OUTLAYS FOR HOUSING AND COMMUNITY DEVELOPMENT

1965 — -$317

BUDGET OUTLAYS FOR PUBLIC ASSISTANCE

$2,869 — 1965

BUDGET OUTLAYS FOR LABOR, MANPOWER, AND OTHER WELFARE SERVICES

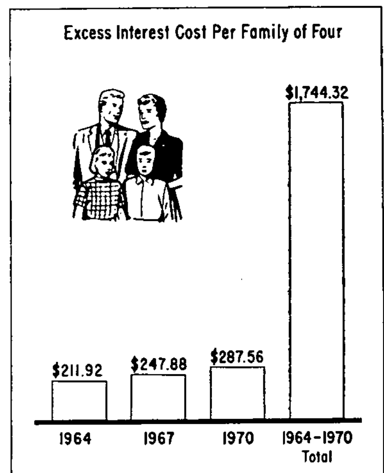
$1,230 — 1965

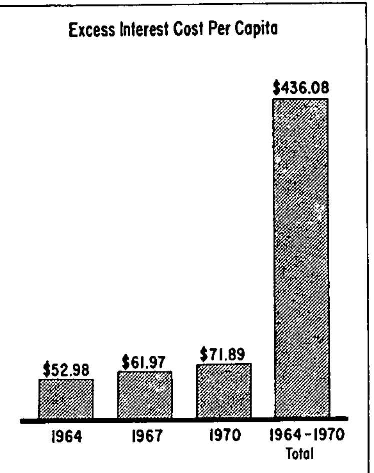
*Interest cost, calendar years; Budget outlays, fiscal year 1965, as proposed in the President's Budget.

CHART 18

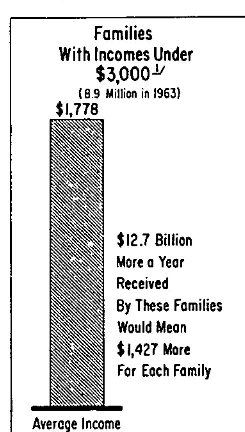
HOW 88.7 BILLION DOLLARS IN EXCESS INTEREST COSTS, 1964-1970 WOULD BURDEN THE AMERICAN PEOPLE

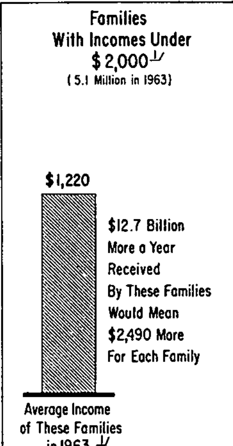
Calendar Years

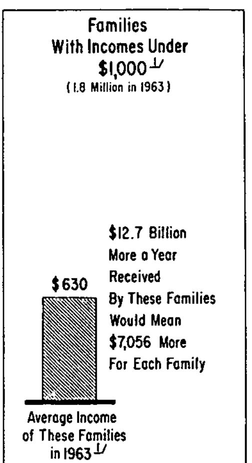




HOW $12.7 BILLION A YEAR, 1964-1970 -THE ANNUAL EXCESS INTEREST COST- COULD BE USED TO RELIEVE POVERTY



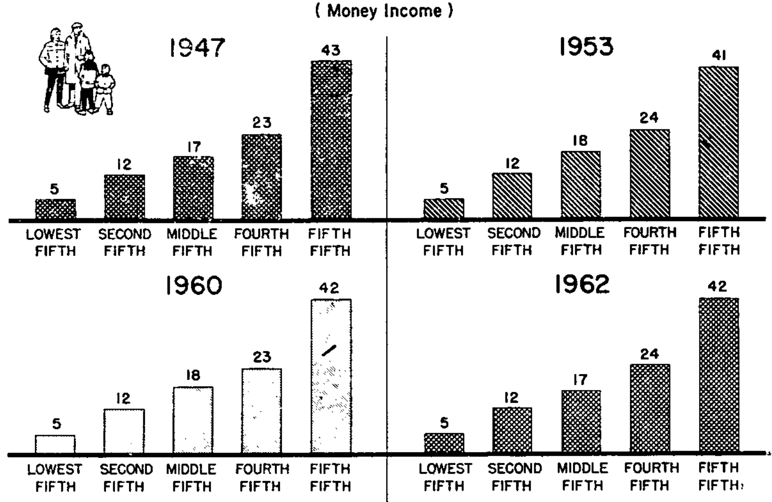


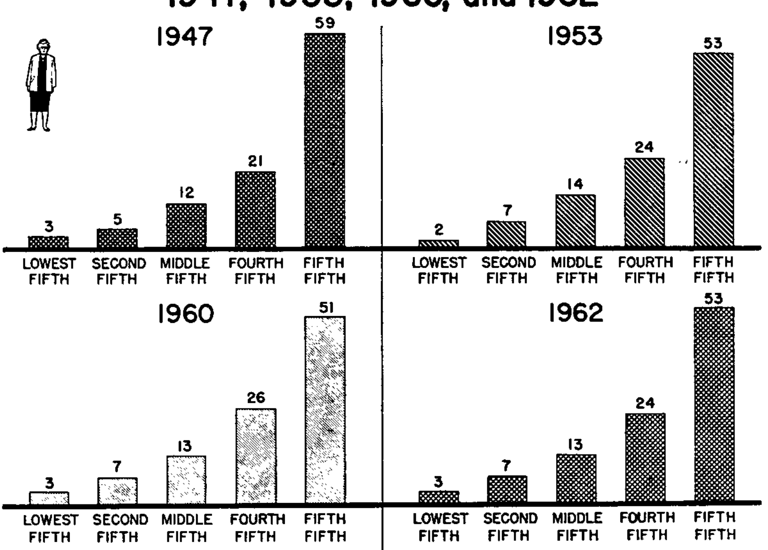


Note: Family and Income Data from Bureau of the Census.

1/ Income distribution analysis is stated in 1962 dollars because the original determination of the income needed to lift families above the poverty level was made in terms of 1962 dollars.

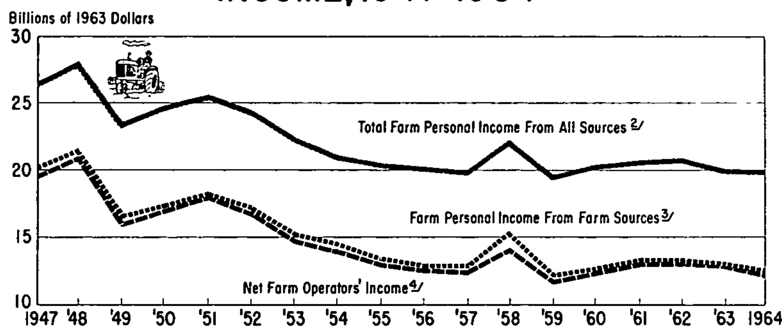
CHART 19

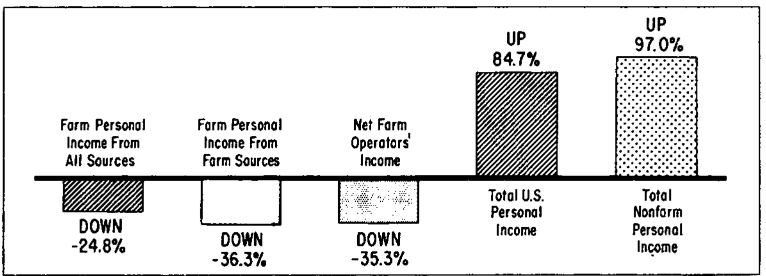


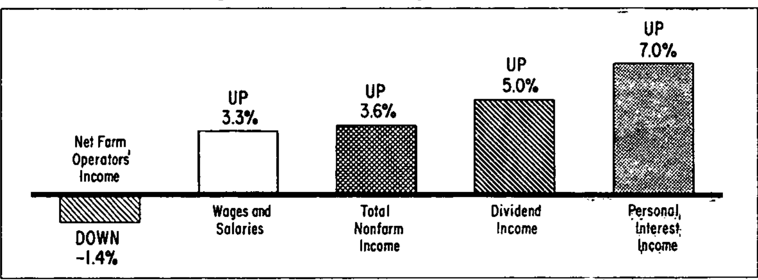


Data: Bureau of the Census.

CHART 20







1/ 1964 estimated on basis of first three quarters.

2/ Total farm personal income is total net income, before taxes, and includes income of farm people from farm and nonfarm sources.

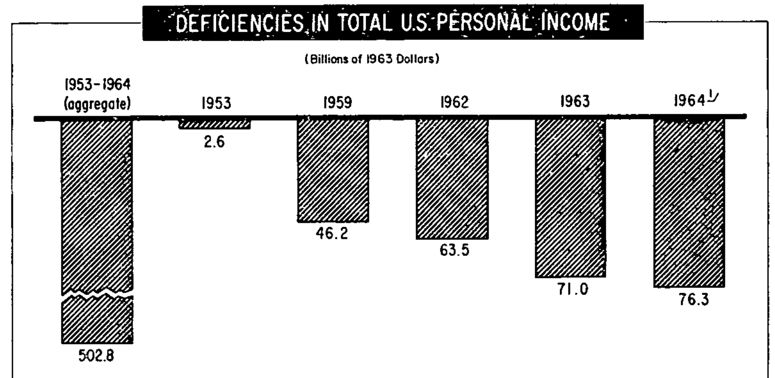
3/ Farm income from farm sources is net farm operators' income of resident farmers, plus wages of farm resident workers and their nonmoney income, less social insurance contributions.

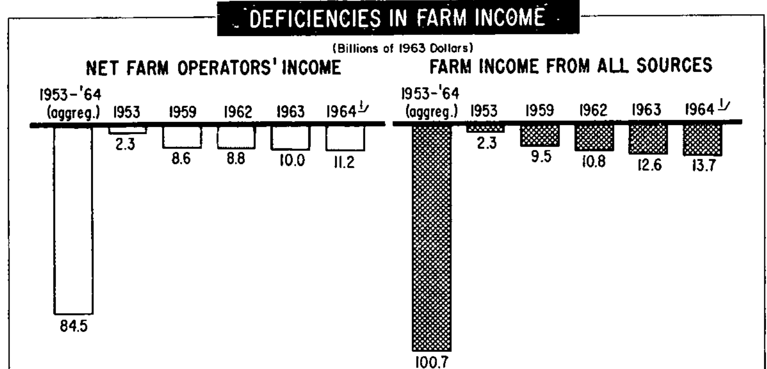
4/ Net farm operators' income is their income from farm marketings, less production expenses; their nonmoney income; Government payments; and adjustment for inventory changes.

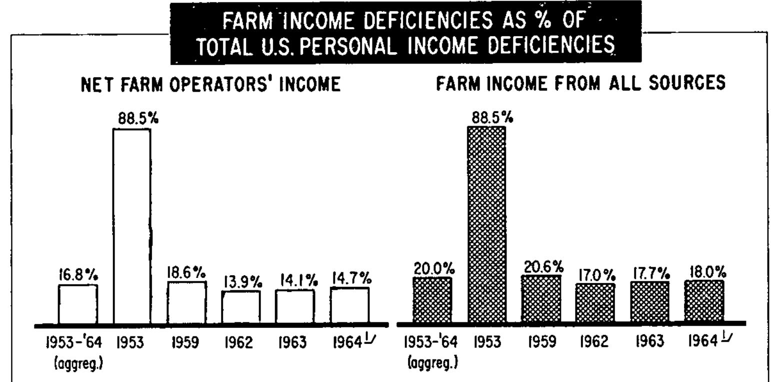
Data: Departments of Agriculture and Commerce.

CHART 21

IMPACT OF FARM INCOME DECLINE UPON U.S. PERSONAL INCOME DEFICIENCIES





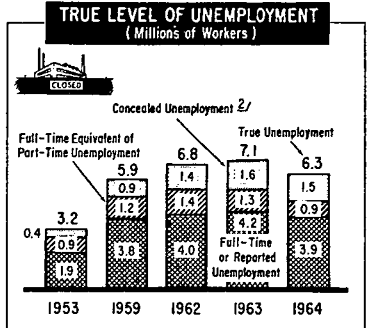


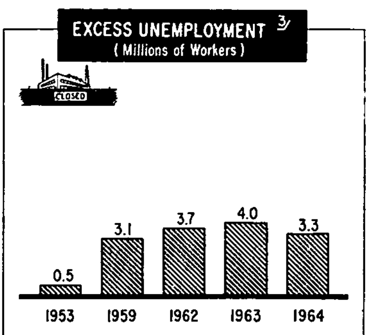
[1] 1964 estimated on basis of first three quarters.

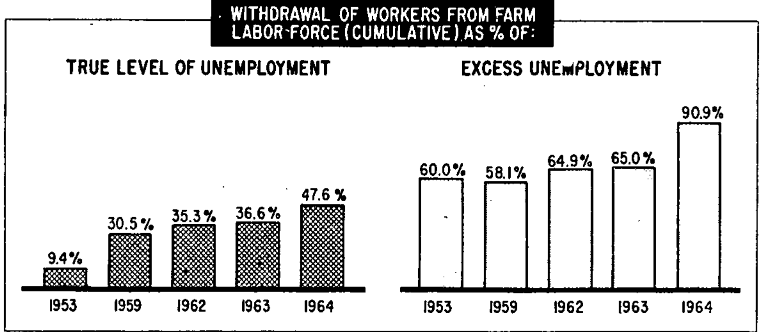
Data: Actuals, Depts. of Commerce and Agriculture; deficencies, estimated by CEP

CHART 22

IMPACT OF FARM WORKER DECLINE UPON TOTAL UNEMPLOYMENT IN U.S., 1953-1964[1]







1/ 1964 estimated on basis of first ten months.

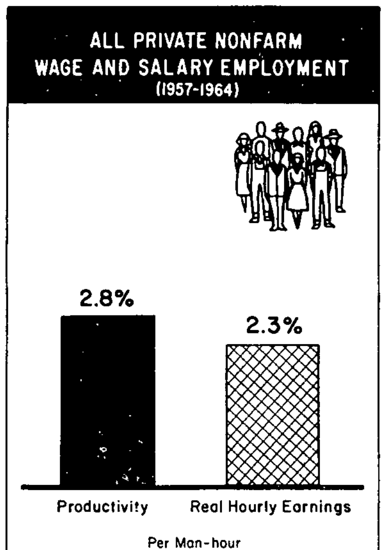
2/ Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

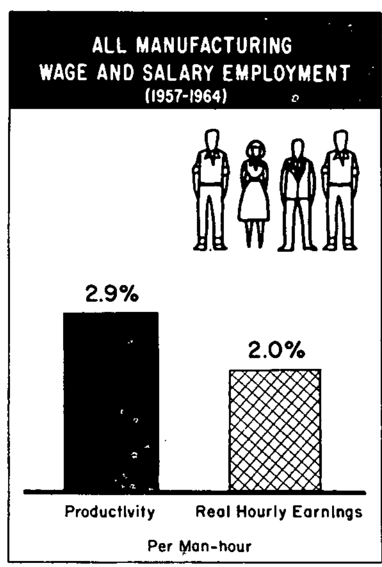
3/ Unemployment in excess of levels consistent with maximum employment.

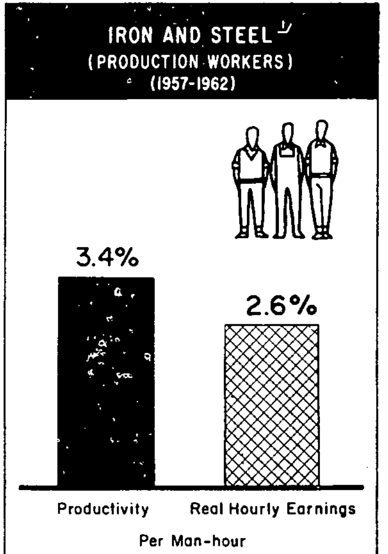
CHART 23

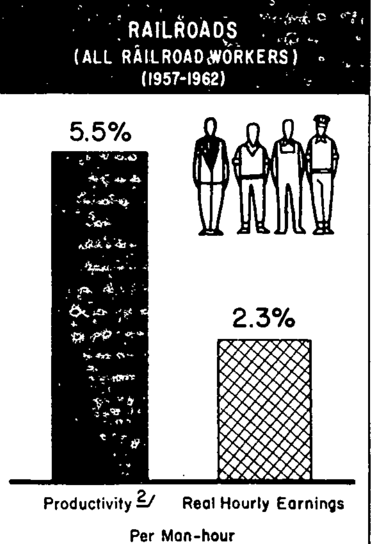
COMPARATIVE TRENDS IN PRODUCTIVITY AND REAL HOURLY EARNINGS, 1957-1964

Average Annual Rates of Change









1/ Estimated by United Steelworkers of America.

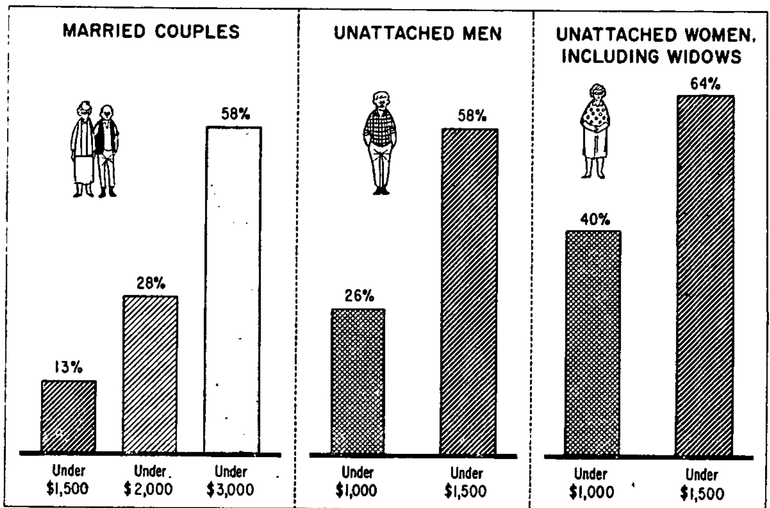
2/ Productivity based on trends in traffic units per man-hour as reported by I.C.C.

Basic data: U.S. Dept. of Labor (except as noted)

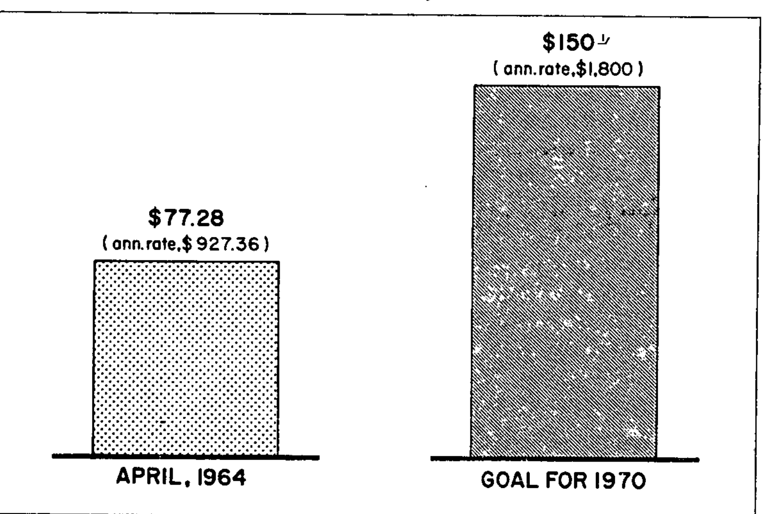
CHART 24

POVERTY AMONG OASDI BENEFICIARIES AGED 65 AND OVER, 1962

Percent at Indicated Money Incomes From All Sources



AVERAGE OASDI BENEFIT, RETIRED WORKER



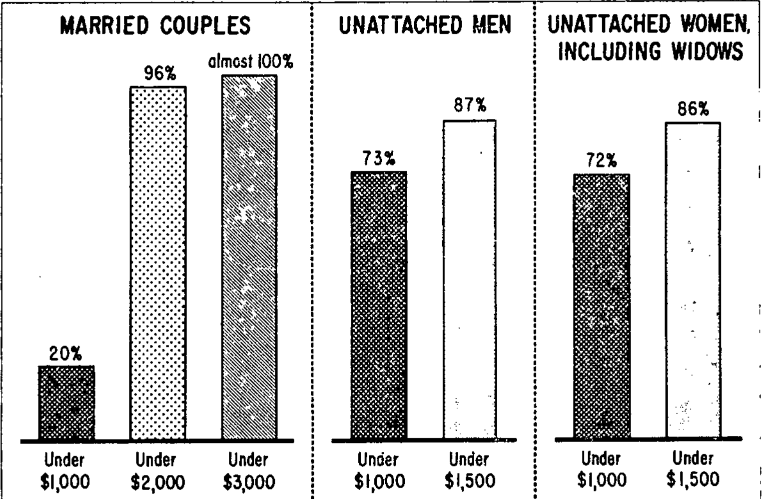
[1] Benefits for wives and widows should be comparably increased, to lift married couples and unattached women out of poverty.

Data: Dept. of Health, Education, and Welfare. Projection, CEP.

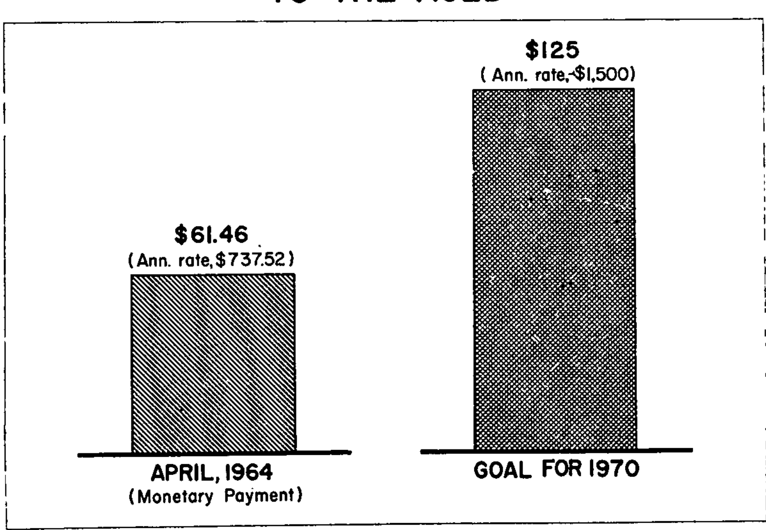
CHART 25

POVERTY AMONG RECIPIENTS OF PUBLIC ASSISTANCE, AGED 65 AND OVER, WHO DO NOT RECEIVE OASDI BENEFITS, 1962

Percent at Indicated Money Incomes From All Sources



AVERAGE PUBLIC ASSISTANCE BENEFIT TO THE AGED



Data: Dept. of Health, Education, and Welfare. Projection, CEP.

CHART 26

DIFFERENCES IN RESULTS OF HIGH AND LOW ECONOMIC GROWTH RATES, 1964-1970

Bold face - Difference in 1970; *Italics - Difference for seven year period as a whole*

(Dollar figures in 1963 dollars)

Item	Difference in 1970	Difference for seven year period as a whole
EMPLOYMENT [1/] (In millions of man-years)	**8.2**	*40.1*
UNEMPLOYMENT [1/] (In millions of man-years)	**-4.5**	*-21.7*
TOTAL PRODUCTION	**$163.3 Billion**	*$697.3 Billion*
CONSUMER SPENDING	**$99.3 Billion**	*$428.5 Billion*
PERSONAL INCOME	**$133.8 Billion**	*$574.2 Billion*
FAMILY INCOME (Average for Multiple Person Families)	**$2,125**	*$9,000*
WAGES and SALARIES	**$82.5 Billion**	*$333.2 Billion*
NET FARM INCOME	**$19.5 Billion**	*$95.2 Billion*
TRANSFER PAYMENTS	**$16.3 Billion**	*$81.4 Billion*
UNINCORPORATED BUSINESS and PROFESSIONAL INCOME	**$10.0 Billion**	*$45.7 Billion*
GROSS PRIVATE DOMESTIC INVESTMENT [2/]	**$47.5 Billion**	*$203.9 Billion*
RESIDENTIAL NONFARM CONSTRUCTION	**$16.5 Billion**	*$78.9 Billion*
FEDERAL, STATE, AND LOCAL GOV'T OUTLAYS FOR GOODS AND SERVICES	**$16.5 Billion**	*$64.9 Billion*

1/ High growth rate would draw more persons into the labor market than low growth rate.

2/ Including net exports of goods and services.

CHART 27

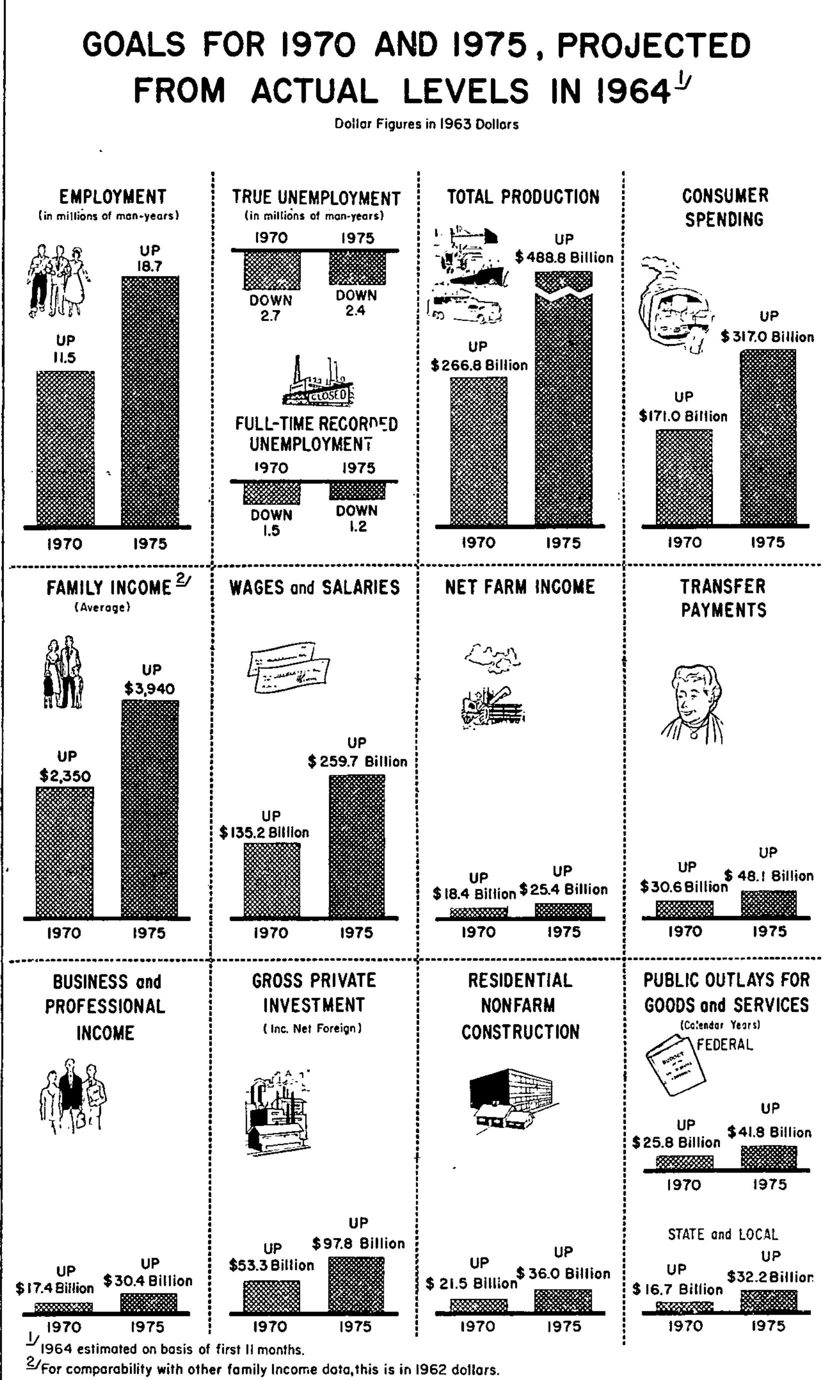
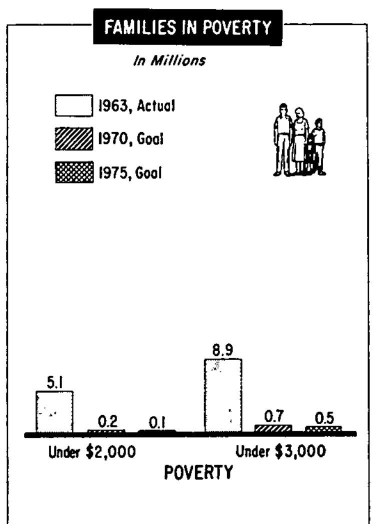
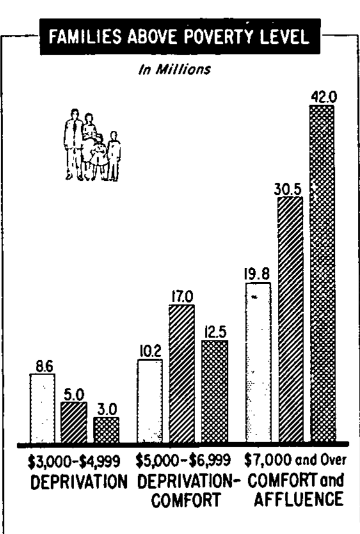
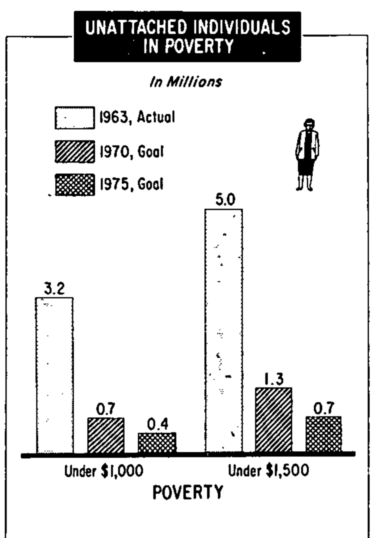


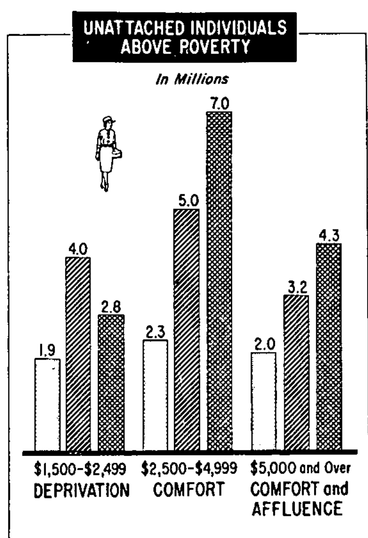
CHART 28

GOALS FOR REDUCTION OF POVERTY IN U.S. AND FOR OVERALL INCOME GAINS, 1970, '75[1]







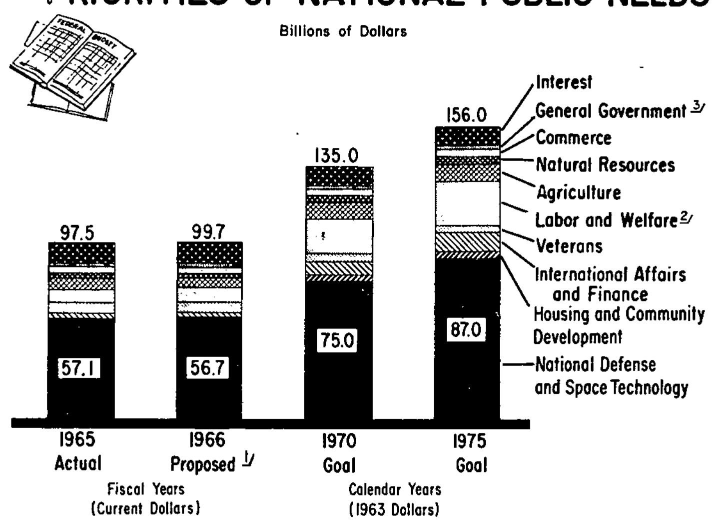


[1] Annual Money Income Before Taxes, in 1962 dollars.

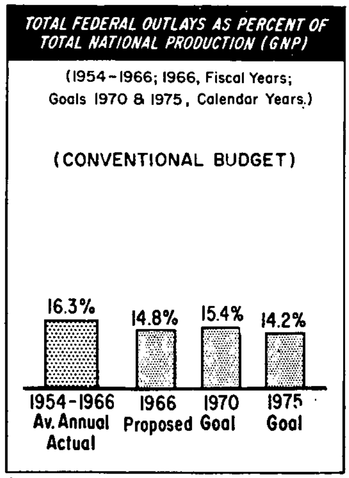
Data: 1963, Bureau of the Census. Projections, CEP.

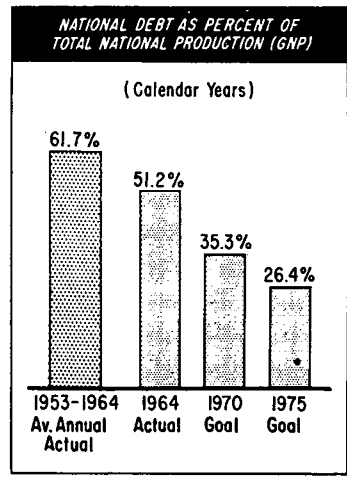
CHART 29

TOWARD A FEDERAL BUDGET CONSISTENT WITH MAXIMUM EMPLOYMENT AND THE PRIORITIES OF NATIONAL PUBLIC NEEDS



BURDEN OF FEDERAL OUTLAYS IN A FULLY GROWING ECONOMY WOULD BE LOWER THAN IN RECENT YEARS





1/ As of Budget Message of Jan. 25, 1965.

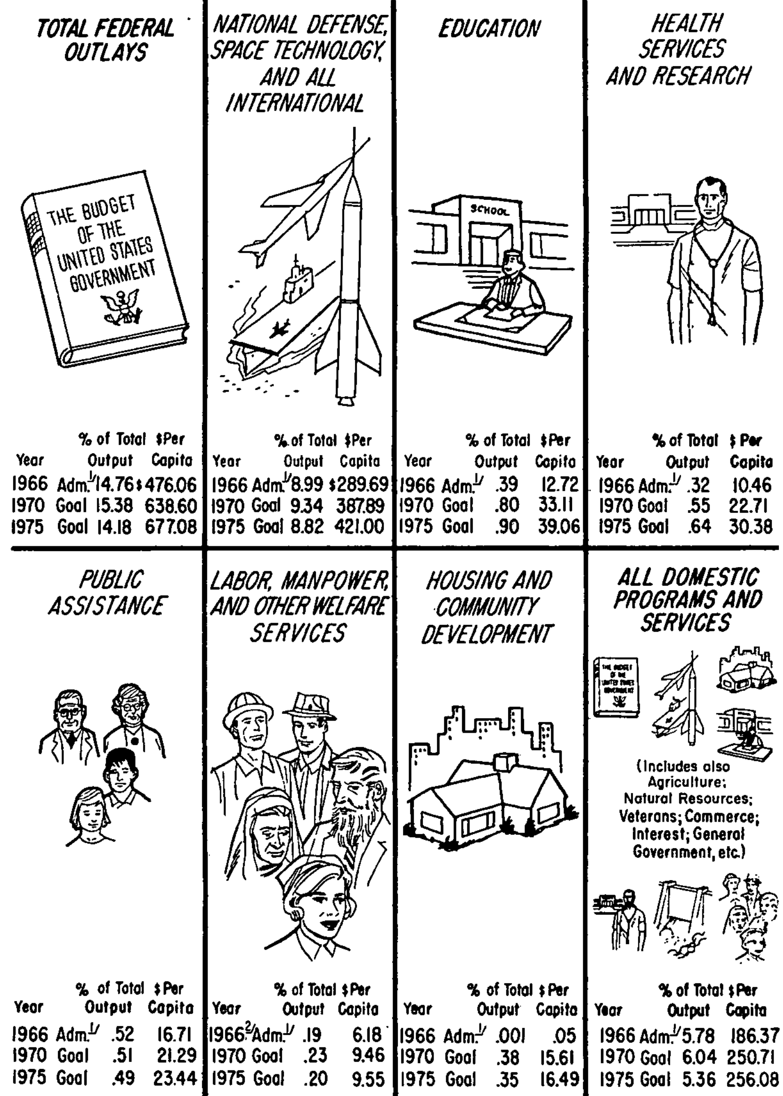
2/ Including education and health services

3/ Including contingencies and less interfund transactions

CHART 30

GOALS FOR A FEDERAL BUDGET GEARED TO ECONOMIC GROWTH AND PUBLIC NEEDS

1966, Fiscal Year: 1970 and 1975, Calendar Years
Per Capita Outlay in 1963 Dollars



TOTAL FEDERAL OUTLAYS

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	14.76	$476.06
1970	Goal	15.38	638.60
1975	Goal	14.18	677.08

NATIONAL DEFENSE, SPACE TECHNOLOGY, AND ALL INTERNATIONAL

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	8.99	$289.69
1970	Goal	9.34	387.89
1975	Goal	8.82	421.00

EDUCATION

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	.39	12.72
1970	Goal	.80	33.11
1975	Goal	.90	39.06

HEALTH SERVICES AND RESEARCH

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	.32	10.46
1970	Goal	.55	22.71
1975	Goal	.64	30.38

PUBLIC ASSISTANCE

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	.52	16.71
1970	Goal	.51	21.29
1975	Goal	.49	23.44

LABOR, MANPOWER, AND OTHER WELFARE SERVICES

Year		% of Total Output	$ Per Capita
1966[2]	Adm.[1]	.19	6.18
1970	Goal	.23	9.46
1975	Goal	.20	9.55

HOUSING AND COMMUNITY DEVELOPMENT

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	.001	.05
1970	Goal	.38	15.61
1975	Goal	.35	16.49

ALL DOMESTIC PROGRAMS AND SERVICES

Year		% of Total Output	$ Per Capita
1966	Adm.[1]	5.78	186.37
1970	Goal	6.04	250.71
1975	Goal	5.36	256.08

[1] Administration's proposed Budget as of Jan. 25, 1965

[2] This item does not include the outlays for the Economic Opportunity Act program, $1,346 million in the 1966 Budget.

Mr. KEYSERLING. I would like to summarize a few of the points I have made in my prepared testimony.

I am very sorry that I do not share completely in the glowing sentiments with respect to the economic situation or with respect to the Economic Report. I had an example of my feelings when coming up in the elevator this morning. I came up in the elevator, but when I got to the top the door did not open. So I thought I was locked in. I went down. When I went down the door opened. When I came up again the door did not open. I finally found, with the help of some of the able staff of this committee, that the reason the door did not open was that I was looking at the wrong door.

I needed to turn around and look at the door that led out of the elevator. I am very much afraid that the country, and many of the economists, are looking at the wrong door. Aside from the other witnesses here today, we have heard a great deal about credit policy, we have heard a great deal about interest rates, we have heard a great deal about taxes, we have heard a great deal about everything except the one basic, central problem, which is the problem of unemployment.

I am, to be sure, pleased with the long parts of the Report of the Council of Economic Advisers which, in glowing generalities, talk about what the Great Society is going to do to get rid of poverty and to provide us with decent housing and adequate social security, and so forth. But some of this reminds me very much of the words of an 18th century poet: "Words are like leaves, and where they most abound, full fruit of sense beneath is rarely found."

Shakespeare said it even more quickly, "Words, words, words."

The truth of the matter is, and I have nothing on my side except the facts, and the verification by recent experience of what I have said before this committee in years gone by, the truth of the matter is that we have made rather small progress in reducing unemployment during the most recent years.

In this conection, the Council's Report, for the first time, recognizes the validity of the measurements of unemployment which I have for many years been submitting to this committee. First of all, there is now a general recognition by economists that, if we are going to count unemployment, we have to count not only full-time unemployment, but also the full-time equivalent of part-time unemployment.

This is now recognized. Three years ago before this committee, I began to point out that there was still another type of unemployment, concealed unemployment. For the first time, the Council recognizes this. And the President's Report says that, even if we got the unemployment rate down to 4 percent, there would be a million additional entrants immediately into the labor force.

This means that, as the economy expands, the people who are really in the labor force, but who had not been looking for jobs because they had been so discouraged, begin to look for them, and thus the labor force as usually counted grows faster.

My chart shows that we have not 5 percent unemployment, but 8 percent unemployment as a percentage of the civilan labor force; the number is about 6 million, not 4 million.

Furthermore, we have become accustomed to adjusting unemployment seasonally from month to month, but not for the phases of the business cycle. When we take account of the fact that we are now

near the top of a long stretched out "boom" about which I will say something, and adjust cyclically for that, we find that unemployment now is higher than at the peak of the previous "boom."

So, when we adjust properly for what I call cyclical factors, as well as for seasonal factors, we made very inadequate progress. Whether we have made progress or not, 5-percent full-time unemployment when it ought to be less than 3 percent, and 8 percent true level unemployment when it ought to be about 4 percent, is a shocking condition for a great nation after 4 years of efforts to reduce it, and I won't go into the more distant past; I am not one of those economists who comes up here with political comparisons among various administrations.

Eight-percent unemployment or five-percent unemployment in a great nation is shocking. It is more shocking when we realize that, due to the rotation of unemployment among different people at different times of the year, there are 20 or more percent of the Nation who have a bitter taste of 3 months or more of unemployment in the course of the year, which brings them below the poverty level if they are not already there.

It is even more shocking when we recognize that our young people, and I am not prone to exaggeration, are being transformed into a "wolf pack" by an economic society which is saying to them, "You are not wanted," and we all admit that the unemployment among those people is 3 or 4 times as high as generally.

What does the report of the Council propose to do in the fulfillment of its primary mandate to define maximum employment, and devise a program to achieve maximum employment? This report perhaps more than previously, abdicates that responsibility and forgets about it. I will enter into a simple mathematical demonstration, drawn from the report itself. The Council's report says categorically that the labor force, over the next few years, is going to grow by 1.7 percent a year.

Then, the report says categorically that productivity during the last 4 years has grown about 3.5 percent a year for the whole private economy.

The report also says categorically that, if the economy expanded faster, the labor force would grow even more than 1.7 percent, and productivity would grow even faster than 3.5 percent. But without regard to that additional factor, just add the 1.7 percent and the 3.5 percent, and we get 5.2 percent—right out of the Council's report.

What does this mean? This means that the economy has to grow 5.2 percent a year to hold its own, even with regard to the annual increments in the labor force and in productivity under conditions of high resource use.

This is the 5 percent or better which I have been using for a number of years. That is point one.

Point two is that this is not enough, because we now have excess unemployment of about 3 million, when we count it properly. If we were setting out—and I won't go into all the details here, they are in my prepared statement—if we were setting out, within 2 years, to get back the maximum employment, we would need, taking into account the 3.5-percent productivity growth rate that I mentioned, and the 1.7-percent growth in the labor force I mentioned, and getting rid of the

3 million excess unemployment within 2 years, we would need a growth rate in the employed labor forces of about 4 percent a year, and if we add that to the 3.5-percent growth rate in productivity, we get 7.5 percent.

I use 8 to 9 percent, when we take account also of what the Council now admits, the effect of accelerating economic growth upon productivity and the labor force. So, in the face of the need for a 5.2-percent growth rate even to stay even, and a 7.5- to 9-percent growth rate to get back to full employment, what does the Council say?

The Council merely makes a forecast that, in real terms, the economy is going to grow by somewhat less than 4 percent during the next year, and accompanies this forecast with an explicit admission that the Council itself does not expect this to reduce unemployment below the current level, although it may reduce it a little bit below the 5.2-percent rate for 1964 as a whole.

I submit that this is a complete negation, a complete abandonment, of the fundamental statutory responsibility under the Employment Act. And I say, secondly, that the 3¾-percent rate which the Council uses for determining how much growth we need merely to keep even is utterly out of line with its own 1.7-percent figure and its own 3.5-percent figure.

So we have abnegation. Now let us come over to the matter of policy. There are three basic ways that have been discussed to deal with unemployment:

One is called the structural approach. The structural approach implies, as of the economic and social conscience of the 1920's, that the main reason people are unemployed is that there is something wrong with them, and that if we train them and educate them and process them, and take them away from their families and put them into camps and give them some training, they will get jobs.

Now, I am certainly in favor of education and training. I am for as much of it as anybody else, but I say that this is not the main way to deal with the unemployment problem.

The main way to deal with the unemployment problem is to create jobs. We should have learned this from our World War II experience. At its start, we had had 9 to 15 million unemployment for many years, and it might therefore have been assumed that millions had lost their skills and morale. In addition, we drew 18 million people into the Armed Forces, who had never had much training because they were young. Yet the people went into the Armed Forces, they learned to do things more complicated than the highly complicated things we now say exist in the modern economy. The women went into the factories, the middle-aged farmers went into the factories, and they performed. Why? Because the jobs were there.

In the second place, we can't train people adequately for jobs, unless we know what jobs we are training them for. Unless we weld the training and education program to a long-range job budget which says what kinds of jobs the American economy needs to absorb these people and creates these jobs, the training programs will not succeed. It is like saying that, when the Titanic sank, the men drowned because they were men. Actually, they drowned because the boat sank, and there were not enough lifeboats to go around.

The second approach is that we can create jobs by increasing aggregate demand. Pump more spending power into the economy, the

money is spent, and therefore there are more jobs. This is right in a sense, but it is a mere truism. Saying that, if there is enough demand everybody will be employed is like my saying if I pour enough water in this glass to fill it, it will overflow.

Instead, we need to pay far more attention to the composition of the demand. What many economists have ignored, because it is not popular, because it is controversial, because they all want to be part of a great consensus, is that the distribution of income fundamentally determines whether or not there is enough aggregate purchasing power, because if the distribution is unsatisfactory, the purchasing power will not be exerted in full.

Now, this maldistribution is the very nature of our economic trouble in recent years, as I pointed out several times to this committee. Relatively too much purchasing power is flowing to those who invest in the means of production, and not enough is flowing to those who buy the products, whether they be private consumers—18 million old people of whom 11 million are poor farmers, 43 percent of whom are poor workers, a large portion of whom are poor people generally—and not enough is flowing into public outlays for the goods and services that we most need.

So these two types of ultimate demand, the private demand for goods and services, and the public demand for goods and services, are not keeping up with the investment in plant and equipment.

I want to show you my chart 4, which illustrates that this situation is serious today, and augurs no good for the future. Here we see, down in this bottom right-hand corner, during the last 12 months, that investment in plant and equipment has increased at an annual rate of 11.8 percent, and public and private demand together, represented both by consumer spending and by public outlays, has increased only 4 percent a year. If we take the whole 4 years from the beginning of 1961, the investment in plant and equipment has increased 8 percent a year, and the public and private ultimate demand only 4 percent a year.

What does this mean? This simply means that, if the investment goes with the expansion of capacity, we accentuate lag between what we produce and what we can buy. If it goes to what is euphemistically called not expansion of capacity but improvement of efficiency, it merely disemploys people.

Now coming mainly to the main heart of my testimony, I agree that fiscal and monetary policy are the two main instruments for bringing the situation into balance. But our fiscal and monetary policies have not been pointed accurately toward this purpose.

To call a $13 billion annual tax reduction, which we had in 1962 and 1964 combined, modern economics, because it increases aggregate demand, without asking where the tax reduction went, is absolutely fallacious. Let me illustrate this by something I said to the committee in previous years, and I wish we had a Department of Experience in the Government which sometimes checked up on what people have said and what has happened. I said in previous years, and I am not talking about this to cry over spilt milk, because even now we hear talk of another $700 million of amortization allowances, another across-the-board 5-percent tax reduction if the situation worsens in the future, and more tax reduction piled on top of that—I said last

year before this committee that about $7 billion of the $13 billion tax reduction was going in large part to corporations who never in the history of the American economy had so much retained earnings, so much profit margins, and so much available funds for investment as they already had.

The Council of Economic Advisers now admits every one of these facts. Its report has a table which shows that, during the last 4 years, the cash flows have exceeded the rates of fixed investment.

This is fantastic. We don't need a savings system, we don't need banks, we don't need savings and loan associations, if corporations can finance out of the price structure more than their fixed investments.

I said also that the balance of $7 billion of the tax reduction was going to high-income people who would try to invest it, or who would use it to take another trip overseas and aggravate the balance-of-payments problem. (On the uses of the tax reduction, see my charts 10 and 11.)

Now, I know everybody is concerned about the balance-of-payments problem, as depicted on my chart 14. In 1964, the outflow of U.S. private capital was about $6 billion a year, or almost twice as high as a couple of years earlier, and in the fourth quarter of 1964, I haven't got all the figures, but evidently it was very much higher, at an annual rate. What has happened?

We have seen very large parts of the tax reduction used to finance the outflow of U.S. capital to other countries, and then we are so contradictory that we want to impose other kinds of taxes to bring back home some of the American capital that we induced to go overseas by the tax bonanzas that we gave.

So, fully half of this marvelous, modern, more successful than anything before tax reduction, successful in everything except reducing unemployment, has gone (a) to increase our balance-of-payments problem overseas, and (b) into the stock market, to bid up the prices in an in-continent stock market boom which does not create a single job but is merely paper values.

The money policy, aside from its restrictive effect on economic growth as I show in my chart 16, has transferred $50 billion in a regressive direction since 1953. It has transferred $50 billion out of the hands of farmers, small businessmen, homeowners, average consumers, purchases of durables, and Federal, State, and local governments.

About 11 percent of the Federal budget is devoted to interest payment alone. If we take together these two twin cylinders, the tax policy and the money policy, they have been moving largely in the wrong direction from the point of view of dealing with the problem of unemployment.

Incidentally, while we have been seeking to increase aggregate demand through the tax policy, we have been reducing aggregate demand through the restriction monetary policy. We are using these two policies in conflict, on the rationalization that rising interest rates will prevent money from going overseas. This is not the case. Money is not then going overseas looking for interest rates. I said this before this committee 4 years ago, and 4 years in a row, that money is going overseas looking for profits.

Ford is building plants overseas. He is not doing it for interest rates. He is doing it because American corporations, and high-income

savers, have been plied with more investment funds than they can use in the United States under current conditions. How much better would it be to follow an economic policy which provided more opportunity for investment in the United States, by lifting the underdeveloped market of the 77 million people in the United States who are poor and deprived. Then, we would have more room for sustainable investment in the United States, the money would not flow overseas, the balance-of-payments problem would be lessened, and we would be better off in all respects.

Another main reason why the tax reduction does not reduce unemployment much is this. We do not decrease unemployment by increased demand, unless the increased demand is faster than the rate of advance in technology and automation in the areas of production against which the demand is exerted. In other words, the automobile industry today is producing 9 million cars, as against 7 million in the banner year 1955, and they are doing it with several hundred thousand fewer workers, because 58 people in the automobile industry today can turn out what a hundred turned out in 1955.

This is the whole problem of technology and automation, and it extends across the whole American economy, in steel, automobiles, chemicals, on the farm, and even increasingly in office work.

So when we, by tax reduction, increase the demand for products, unless we can increase that demand faster than the rate of advance in technology and automation as to these products for which the consumer spends the money, we are not going to help unemployment much.

Consequently, the only way we can do much about the unemployment problem is to increase the demand for those types of products where the Nation's needs are so great that meeting those needs would expand output faster than the technology and automation are growing in those areas of output.

This is a simple A B C. I see little recognition of this in the Council's report. I see little discussion of it. I have budgeted, in my studies, the exact relative trends in technology and automation and employment in all major sectors. What do I come up with? If we are going to meet the need which the Government certifies for 22 to 27 million additional jobs in the next 10 years, we will have to get a shift not just in the structure of the labor force—these people will be employed if there is a chance for them to have jobs—we have to get a shift in the structure of demand.

In other words, we have to start meeting our needs for decent housing among the one-fifth of the people who don't have it. We have to rebuild our decaying cities, we have to improve our mass transportation, we have to develop more education and health facilities and services.

This would not be "made work." These would be things that the Nation needs in the war against poverty. And would have multiple effects upon private investment. Fortune magazine is talking now about the neglected half of America, which is the sector of the economy which only Mr. Galbraith and a few others and I were talking about a few years ago, and which the New Frontiersmen and Great Society experts were talking about until they got into the Government.

Unless we make a move in these directions, we are not going to

reduce unemployment substantially. When we get into the next economic recession, we will have much higher unemployment than now, more than we had at the last trough or the last recession.

In some of my other charts, I attempt to identify some of the areas on which the Economic Advisers should be concentrating. They ought to be concentrating on how we can get a larger share of our national purchasing power into the hands of those who need it most, and who are the best consumers relative to their incomes, and thus bring into balance our growing productive capacity and our ability to consume.

Who are these groups, most needing rapid income gains? I take them one by one. First, we have a war against poverty, which does far too little about 11 million poor people, or one third of the total poor, who are among our 18 million senior citizens; sure, we have in the Congress this year a bill to increase social security payments a little bit. Sure, the Council of Economic Advisers takes pride in the fact we are going to have $600 or $700 million of increased payments to these people next year. But what do they say about the fact that, immediately after that, we are going to impose more of the regressive payroll taxes which will take as much away as they give, so that we have no net stimulus there? How much better it would be if, instead of spending $50 billion over 11 years in regressive interest payments, and $6 billion additional in the Federal budget alone, we made a one or two billion dollar contribution to a liberal and adequate social security system on a nonregressive basis.

This would increase purchasing power, it would fight poverty, and therefore it would create jobs. This is area No. 1 which we are neglecting seriously. I don't think we should go any further with the social security system until we analyze what its real economic significance is, and how it is being financed, and how we are coming out on it.

Second, there is the farm problem. The Director of the Budget says we need two and a half million fewer families. To go where? Into the steel industry, or chemical industry, or the offices, which are being automated? Into the Government service? Where does he want them to go? Furthermore, when we figure out the quantitative cost, to the cities, of the poverty and unemployment and misery which has been caused in the cities by the farmers who have been forced off the land, it comes to billions.

I have a chart here (chart 22) which shows that if we look at the excess unemployment today, one-third to one-half of all of it is equivalent to the cumulative number of farmers who have been forced off the land since 1953.

I don't want the farmers to stay on the land playing with diablos. There was a study in the Washington Post recently, of how many families in Washington are living on indecent diets. We should be using fully our farm productive capabilities. The economic and social cost of helping farmers to stay on the farm, on a decent basis, and rehabilitating them, would be a mere bagatelle compared with the cost of their continuing to flow into areas where they cannot possibly be used in view of the new technology and automation.

Third, there is housing. We are developing two Americas. Eighty-five percent of the children in the schools in Washington, D.C., the Capital of the Nation, are Negroes. I don't care anything about the color of their skins, but I do care about what this is a reflection of.

What is it a reflection of? It is a reflection of the fact that Washington is becoming a city of the poor, and so is New York, and so is Chicago.

So we have two Americas, the poor people living in the cities, the well-to-do people living on the outside. The affluent people don't care, because their schools are good. Meanwhile, cities can't raise the money to finance education and to finance their other needs.

James B. Conant, who is an educator, when he wrote "Slums and Suburbs," determined that the slums are just as significant as the schools, because you can't take children out of slums, broken families, unemployed families, low-income families, and send them to school and expect them to stay there.

If we budgeted a long-range 10-year program to rebuild America and to rebuild our cities this would take care, in view of the new technology and automation, of one-half of the whole 22 to 27 million job problem over the next 10 years.

Now, maybe we should not do that much. But at least, we should be thinking in those terms.

Yet the Council is complacent in the fact that the level of housing starts next year is going to be about the same as this year. The Council does not identify, in terms of the new technology and automation, that the housing area requires more expansion as a vital attack upon the unemployment problem and to the poverty problem and the economic growth problem.

We have a meritorious war against poverty, but still we are closing our eyes to some of the main elements in it. The Employment Act of 1946 was a great undertaking in attempting to budget on a long-range basis, as a guide to policy and program, our relative national needs, and how we could construct a budget of maximum employment, production, and purchasing power.

We need income and product flows, in the different areas, which will provide a viable pattern of economic growth, consistent with our economic needs, consistent with our technological development, and consistent with our social conscience because in a wealthy economy all of our objectives must be social as well as economic.

We are interested in what happens to people. Our economy exists to serve human needs; if we made that kind of long-range budget, we would see that we need a different kind of tax policy. I have the greatest regard for the President. But when he goes and asks some businessmen not to invest more money overseas, and then as an inducement to them not to invest money overseas says that we will give you another $700 million to invest in the form of still more tax cuts, there is something wrong in what his economic advisers are telling him.

I don't believe in giving people more money to invest, when they already have more than they need; we can't cure that by mere imprecations to Americans not to travel overseas. I think we want Americans to travel overseas, and we want them to learn more about the world. We send the Peace Corps overseas.

This is no way to solve the balance-of-payments problem. If we would reshift our tax policies and reshift this unconscionable monetary policy, we would do much better on all fronts. We have had, during the last 11 years, a 2-percent annual expansion of the money supply.

This cannot support adequate economic growth. This policy has been a little better in the last few years, but it has not been nearly good enough. Everybody is neglecting the interest toll aspect of it. An attribute of money policy is the shifting, by now, of $8 to $10 billion a year from where it would do the most good to where it does the least good.

Let us not be so quick in joining in this refrain that we are well on the way to the solution of our problems, and that everything looks fine. We have not reduced unemployment very much. We have not achieved an adequate rate of economic growth. We have had some abandonment of the objective. The Council of Economic Advisers itself says—I would like you to read one paragraph of the Council's report. The Council's report says that this economic recovery has not been distinguished by bringing us back to full resources use. It has been distinguished by its length. Now, this is exactly what I have been saying, that we have gotten a long recovery by postponing indefinitely, a satisfactory recovery. We have had the patient in bed for 9 months, when he should have been out in 3 weeks, and we brag about what a long recovery he is having.

When after 4 years or 8 years or 10 years we still have 5- or 8-percent unemployment, and not really less than we had allowing for the cyclical variations, we should not be bragging about a long recovery. I don't want 4 more years of this kind of recovery. I am very much worried, when I see the Council saying, as to 1965, that they don't even expect to get unemployment appreciably lower.

If anybody challenges this, it is right in here. They say categorically that they doubt whether unemployment will be much lower in 1965 than now. The appraisal they are making of their own policies is that these are not policies which will reduce unemployment much. I say that an economic review by the Council which does not propose policies which in the judgment of its own proponents will reduce unemployment much is an economic review floating a million miles away from the basic purposes of the Employment Act.

I am sorry to be critical, but I think that somebody has got to distract attention a bit from this aura of complacency. I heard some of my best economic friends come before this committee, and, my goodness, in their eyes we have the best Council, the best performance, the best ever in the world, or that the world ever dreamed of. I do not think we should claim so much. The campaign is over. Now that the campaign is over, let us get back to the business at hand.

Thank you very much.

Chairman PATMAN. I will recognize Senator Miller first.

Senator MILLER. Thank you, Mr. Chairman. Mr. Keyserling, I enjoyed your usual articulate explanation, your analysis of the situation. In fact, I think I enjoy hearing you more every time.

I noted that you take a very dim view of the unemployment situation and this should be measured against the glowing statement about increased gross national product which appear in the report. Do I deduce from that that an increase, a mere increase in gross national product does not mean the same thing as "adequate rate of economic growth."

Mr. KEYSERLING. Obviously, as the Council says, the labor force is growing 1.7 and productivity growing 3.5 percent, so the 3¾-percent growth rate it projects is below its own statement of requirements for holding the employment rate even.

Senator MILLER. But we are talking in that connection about productivity. You used the phrase "adequate rate of economic growth." Is there a difference?

Mr. KEYSERLING. Yes; the economic growth is the measurement of the growth in gross national product. Productivity is the measurement of the increased output per hour of the person employed. So, we may have a growth in productivity that is not translated fully into gross national product, and, therefore, results in increased unemployment.

Senator MILLER. I follow that. But can't we get something better than just a simple increase in gross national product as a measurement of what you referred to as adequate rate of economic growth? Isn't there more to economic growth than just an increase in purchases?

Mr. KEYSERLING. Increases in purchases, plus a composition of the purchases which met our national needs. I take both into account.

Senator MILLER. What about our debt structure in connection with gross national product? Would we not be better off if, for example, we had an increase in GNP of $30 billion in a year with no increase in the national debt as against an increase in GNP of $30 billion with an increase in the national debt of, let us say, $20 billion.

Mr. KEYSERLING. Yes, on that illustration. But we would be much better off with an increase of $600 billion in GNP and $3 billion increase in national debt, than with an increase in GNP of $30 billion and $3 billion reduction in the national debt.

Senator MILLER. What I am really getting at is that just to talk in flowing terms about increased gross national product is not going to satisfy your interpretation of what adequate rate of economic growth is.

Mr. KEYSERLING. The adequate rate of economic growth comes first and foremost because an adequate growth in total output is the best generalized measurement.

But we also have to be concerned about the composition of the growth, because the ultimate purpose of our economy is the meeting of human needs. If we could get an adequate rate of economic growth without hospitals and without decent housing for people, this would not satisfy me.

I make the further point that our economic and our social objectives happily coincide, because, in view of the new technology, the very programs which would improve the composition would also enlarge the growth. So far as we neglect that social question, in regressive fiscal and monetary policies, and say that we are being modern because a reduction in taxes adds to aggregate demand, we are making an entirely wrong economic analysis and an atrocious social analysis.

I agree with you that there are many criteria.

Senator MILLER. Thank you. Now you said nothing particularly as I recall about inflation in connection with this situation. I take it if you are concerned with the low-income groups which are the ones usually hurt the worst by inflation, isn't this a factor to be taken into account in any policies that we develop.

Mr. KEYSERLING. It is a factor to be taken into account, of course. But one of the things that the last 4 years have shown, when the growth rate has been somewhat higher than earlier, though totally inadequate, they have shown that the economic idea that there is an absolute correlation between the rate of economic growth and the rate of inflation is absolutely fallacious. We have had less inflation during the higher economic growth of the last 4 years, although I again say it has been far less than we have needed, we had less inflation than previously with economic downturns and at slower rate of economic growth.

The reason is that, in an administered economic system, where we have administered prices and administered wages, both the employers and the workers try to compensate for inadequate sales and volume by lifting their prices and wages faster per unit than they would otherwise.

So, short of a big depression, an inadequate rate of economic growth tends to aggravate rather than to ameliorate the problem of inflation in the long run.

Senator MILLER. Do you not agree that to preserve the purchasing power of the dollar is essential in any of these policies that we develop.

Mr. KEYSERLING. No; I don't agree that to preserve the purchasing power of the dollar is essential. I believe that to preserve and advance the purchasing power of an hour of work is essential. In other words, frankly, my dollar now, or rather a cook's dollar now—I remember when I was down in South Carolina where I was born and grew up, a cook got $3 a month plus board. Now she gets $20 a week, which is $80 a month. That is 27 times as much. Now, the dollar is worth only half as much, but her real income is still 13 times as high. I don't want her to go back to $3 at a very high purchasing power for the dollar. Therefore, the real problem is our real wealth, how much are we really increasing and using our output per capita and translating this into a just increase in the standards of living.

By that I don't mean to imply that I believe this can be done consistently with a raging or high-level inflation. So I would say generally, subject to the qualification I have noted, I am generally in favor of a fairly stable dollar. I think we have been achieving the objective of a fairly stable dollar, but we have not been achieving some other very much more important objectives.

Senator MILLER. Are you in favor of the escalation clause in labor management contracts to reflect increases in cost of living and automatically wage increases?

Mr. KEYSERLING. I am in favor of overall wage increases about comparable to productivity gains. And I am concerned about the fact that, while the overall wage-rate increases have tended to lag far behind productivity gains, the concern of the Council seems to have been entirely with avoiding wage increases that outrun productivity gains.

I don't want wage increases that outrun productivity gains. But the Council is doing an extremely naive thing. Wages are a factor in business costs, and wages are also a factor in consumer purchasing power. We have to consider both. The Council is considering only one. To talk about a balance between prices and wages is wrong, because prices are not income. Profits are income. Why don't they compare profits with wages?

Senator MILLER. Don't you think that a wage earner ought to be entitled to an increase in his wages when the purchasing power of his dollar is going down?

Mr. KEYSERLING. Yes; I think that, if public policy cannot assure a stable price level, that the worker ought to get an adjustment for that. The fact of the matter is, and nobody contests it, the wage-rate increases have been lagging behind the productivity gains, and this is one of the big factors in the unsatisfactory economic situation.

Senator MILLER. Mr. Chairman, I think I have time for one more question.

You talked about doing something about the cities and the root of poverty in the cities and slums but you said nothing particularly about the agricultural area in which I understand one-half of the poverty exists. Do you have any ideas on what should be done about the agricultural situation?

Mr. KEYSERLING. Well, having received my food and clothing and education until I was 25 years old entirely from my father, whose income or lack of income was entirely from agriculture, I am not unsympathetic to that problem.

Furthermore, I have just put out a study on this, which I have sent to Members of Congress—it may not have arrived yet. I think what we are doing to agriculture is unconscionable. I made some brief references to it here. Farm income has been going down in the last few years at an annual rate of 1.4 percent—I have some of the charts here—while other incomes have been going up at an annual rate of 3 or 4 percent. Forty-three percent of our farmers live in poverty, contrasted with less than 20 percent of the nonfarm population.

Education, health, housing, all public services are seriously relatively deficient in farm areas. And the only solution which Mr. Gordon and other deep thinkers seem to have is to say that this will be cured if we take two-thirds of the farmers out of agriculture.

A number of years ago, I was saying that economists tell us that these farmers are going to get jobs in industry. But the jobs weren't there. Then they said "No, they are not going to get jobs in industry, they are going to get white-collar jobs."

The total number of jobs in the private sector has declined in the last few years, and there is nowhere for the farmers to go. It would still be better to have them leave the land, if we were adequately supplied with the things that the farmers produce, but we are not. Among the poor in the United States, they are not starving in the Indian sense, but most of them have diets which are far below the American standard. This is also true of the 34 million above poverty who live in deprivation. The fibers consumed by American industry are very much less than they would be at full employment.

What we ought to be doing for American agriculture is budgeting the full employment policy, a full employment policy for agriculture. In addition, about a third or more of the total excess unemployment in the United States is due to the people who have been forced out of agriculture, and although the farm population is only 7 percent of the national population, and farm income far less than that of National income, about 20 percent of the total deficiency in personal income during the last few years, which has contributed to the lack of adequate demand, has come out of the deflation of farm income.

In other words, the farmer has taken such a disproportionately large share of the income loss that the only thing he is sharing out of all ratio to his numbers, is the economic trouble of the Nation.

Now, we say we are subsidizing agriculture. We are not. When the farm population is providing food and fibers for the rest of us at 58 percent of parity of income, they are subsidizing the rest of us, no matter what the Government books show.

But for the farm program, the farmer would have 30-percent parity of income with others. Because of the farm program, he has 58 percent of parity of income with others, so the farm program is said to be subsidizing the farmer. I say the farmer is still subsidizing the rest of us.

Mr. VOORHIS. Could I add one word to that, Mr. Chairman?

Chairman PATMAN. Yes, sir.

Mr. VOORHIS. The farmers productivity has been rising about 2½ times as fast as other people's productivity. So if we are going to think about basing income on rising productivity his should have risen 2½ times as fast as it has been.

Senator PROXMIRE. These are two very very helpful papers.

I am delighted to see the forthright criticism which we need. I think there is a tendency on the part of all of us to be too uncritical. It is very helpful to get this kind of criticism on the part of Mr. Voorhis whom I have admired for many many years and on the part of Dr. Keyserling.

Dr. Keyserling, I want to say that your study did arrive in my office, farm study, excellent, one of the finest I have seen. There were many charts and so forth that are quite shocking and surprising.

I think even those of us who have studied the farm problem for many years don't realize the great injustice to our farmers who are suffering.

There are several points that you make, Mr. Keyserling, which frankly do puzzle me quite a bit. You talk here about two-thirds of the current consumer outlay deficiencies due to the failure of wage-rate advance to keep up with productivity advances in recent years.

This may be true. You are a very responsible and able economist, but this is something we don't read or hear about. We hear just exactly the reverse. When we look at the economic indicators it appears that wages have advanced quite rapidly, certainly if you compare them with farm income or compare them with most of the indexes of personal income, including rent, including business and professional income and so forth.

On what do you base this conclusion.

Mr. KEYSERLING. Well, it is here, in my chart 23. Incidentally, my figures in no respect conflict with those of the Council of Economic Advisers. It is very disheartening, how much we are in agreement, but only as to the facts.

This is the picture from 1957 through 1964. If you take the more recent years, it is more striking. Now, these are all official figures, Department of Labor figures. The left top sector compares the average annual rate of productivity gains in all private, nonfarm employment, with the wage and salary gains. The right side compares these trends in manufacturing. The left side at the bottom compares them in iron and steel. The right side at the bottom compares them in rail-

roads. Let me say a word in this connection, about what the Council of Economic Advisers is saying.

The Council of Economic Advisers does not disagree with any of these figures. If you look into the Council's report, it shows that, since 1961, the average productivity growth rate, to which I referred, is 3.5 percent. The average growth rate in straight-time hourly earnings is 2.6 percent, as shown in the Council's report.

The Council gets an equivalence by adding in the fringe benefits. Aside from the difficulties of computing the value of the fringe benefits, when we are talking about an economy in which we are suffering from a lack of actively exerted current purchasing power, there is all the difference in the world between many aspects of the fringe benefits which are types of savings, and current wage income.

In other words, I am very worried about the speed at which reserves based upon private pension plans, as well as so-called reserves based on the Federal social security system, are increasing.

We are isolating out of the economy what should be actively rotating in the economy. This requires a lot of study. There is no difference on the figures.

The Council's wage guideline says that wage gains should average the same as productivity gains. I don't question that. But then they go on and say that the wage gains in every industry should average the productivity gains for the whole economy. This is utterly impractical. We would need a nationwide wage fund and profit fund to accomplish that, and I am against any such thing.

Senator PROXMIRE. It seems to me this is something which has been argued by labor economists for years. I can recall at Harvard, Sumner Schlicter making this very point. His argument was that if you didn't do this you would have a gross disparity in which people who worked in industries that made large productivity gains would get large increases in wages and those who worked in industries with no productivity gains would get no wage increase.

Mr. KEYSERLING. From the point of view of purchasing power, we want wage-rate gains to average the same as productivity gains. This, the Council says, and I agree with it. But if, in the steel industry, the productivity gain is 5 percent, and the nationwide productivity gain is 3½ percent, and we, therefore, hold the wage-rate gain in the steel industry at 3½ percent, we would not get wage-rate gains of 3½ percent in the low-profit, low-productivity industries.

If we hold the wage-rate gains in the high productivity industries to a nationwide average of productivity gains, the nationwide average of wage-rate gains is going to be very far below the nationwide average of productivity gains. This is what has been happening.

Senator PROXMIRE. The Council of Economic Advisers says you should increase the wages in the low-productivity industry by the national average too and then increase prices in those areas, decrease prices in the high-productivity area so that all together you would have a stable price level?

Mr. KEYSERLING. No, they want to decrease the price in the high-productivity areas.

Senator PROXMIRE. That is right.

Mr. KEYSERLING. But that is a mere slap on the wrist there. Nobody is doing that. I am looking at how the economy is working. What I am saying is simply that, even allowing that they could push

a button and get all this done, we cannot in a flexible American economy have the same kind of wage-rate gains throughout the whole economy, unless you have a similar standard applying to profits.

In other words, we cannot ask, either in good conscience or in good economics, a wage earner in the auto industry to take a nationwide average wage-rate gain which results in the automobile industry having the kind of per unit profits it now has.

It is just too exacerbating, and too unfair, and produces all kinds of imbalances. There is one set of circumstances in which it might be proper to say that the wage-rate gains in the steel industry or the automobile industry should be the nationwide average. If we were saying, why should the automobile workers and steel workers have such high gains in their standard of living, why should we not try to bring the people at the bottom up, I would be for that. But then, what would we have to do? To avoid fantastic profits in the steel industry and automobile industry, we would need a progressive tax policy, using the proceeds for housing and social security payments, and all kinds of other things to help the people at the bottom. I would be for that. Under those circumstances, I would say to the Council of Economic Advisers, fine. But when the Council of Economic Advisers combines asking the auto workers to take as wage-rate gains the average for the whole economy in the face of automobile profits, and then our national policy instead of siphoning off these profits to help the people at the bottom, gives the automobile industry more tax reduction, then I must protest.

Senator PROXMIRE. You are assuming, and maybe you are right, but I think I have seen some evidence of price cuts, you are assuming that there are no price reductions in these highly productive industries where productivity is increasing rapidly?

Mr. KEYSERLING. I am not assuming that there are none. But there is a story in the papers today that, for the fifth month in a row, the consumer price level is rising.

The trend is slowing rising prices.

Senator PROXMIRE. Let me ask some other questions. Both your testimony and former Congressman Voorhis' has been so stimulating but I do want to ask one more question of Dr. Keyserling because that is all the time I have.

You advocate policies most of which I agree with whole-heartedly, I must say, faced with what seems to me a problem of international payments which concerns me. I may not be quite as concerned with the international payments situation as some of my colleagues in the Senate are. But it is a serious problem.

You advocate low interest rates which it seems to me would have an adverse effect on the balance of payments. Not very much, very little, but some. You advocate more domestic demand, a massive increase in domestic demand. It seems to me this would increase our imports and hurt our payments balance. You advocate a very substantial increase in wages. That may have an adverse effect on our exports if it pushes up costs or prevents them from rising.

You advocate no cut in business taxes, in fact an increase in business taxes which would have a double effect. If there is no cut in business taxes, business is less inclined to cut its prices because the tax is a cost.

On the other hand you argue that if you maintain your business taxes or increase them, business has less reserves available to put into short-term obligations of foreign governments.

It seems to me that in aggregate, in view of the fact that we have a very unfavorable balance of payments and the Congress and the President are deeply concerned about it, that your program would tend to aggravate this situation.

Mr. KEYSERLING. First of all, I want to amend something you said. I am not advocating an increase in business taxes. I made a remark, in connection with what would be sensible tax policy related to asking auto workers not to take wage increases based on productivity in their industry, that I could support that if we had a progressive tax policy that was siphoning off excessive profits.

I am simply saying that tax reduction has been carried so far already, and the exaggerated claims for the benefits accomplished thereby have so far exceeded reality, that I don't want us to get into a national habit of more and more tax reductions forever. The very people who are saying that the $13 billion in tax cuts have been so successful are using it as an argument that, if the economy should soften a little more at the end of 1965, we should have more of the same. I say, if a $13 billion tax cut can only stimulate the economy a bit and reduce unemployment very little for a few months, we ought to question the remedy instead of talking about more of the same.

If it takes a $13 billion tax cut every few years to stimulate the economy, I fear that in time taxes will approach zero, and I don't believe in taxes going down to zero. So I am saying, let us stop, look, and listen.

Now, on the other point you make, my argument is that, instead of speculating about what might affect the balance of payments, I am merely making the categorical argument which may be wrong, but I think it is right, that actually we gave a $7 billion tax reduction to corporations and people who already had more money than they could use to invest, and thus a roughly equivalent amount got translated into increased U.S. investment overseas and investment in the stock market.

I say we should stop giving more tax reduction to people who don't need it, for them to put it overseas and into the stock market, at the same moment that we are so worried about too much money going overseas. It seems to me that this is a reasonable argument. It is not exactly the same money, but it about balances out. We are taking these people who have retained earnings higher than their investments, very high profit margins, who are not investing more in the United States not because they don't have the money but because they don't have the markets, and we are giving them more money to invest through tax reductions.

Tax reduction when the Government is running a deficit is a subsidy. I am not against this for proper stimulation of the economy. But tax reduction when the Government is running a deficit is subsidy, because the Government is then providing a hundred billion dollars worth of service and taxing only for a substantially lesser amount.

It is just as much a subsidy as if the Government left the tax rates where they were and mailed out checks in given amounts to the people who receive the tax reduction.

Chairman PATMAN. Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

I am pleased to be here this morning and hear these stimulating reports from both of you gentlemen, Mr. Voorhis and Dr. Keyserling.

My first question to Dr. Keyserling would be, if you expect that a growth rate should be 8 or 9 percent to accommodate changes that you would like to see and we are presently going along at 3 or 4 percent, slightly over 4 percent, how long do you believe we can continue at this low rate, which, as you have pointed out, is not even holding our own, before we meet with disaster or a major depression?

Mr. KEYSERLING. "Disaster" is a strong word. I don't think we would meet with a major depression, because I think the political and psychological climate is such that when things begin to get bad enough there will be vast changes in economic policies. What worries me, rather, is that the Nation has become acclimated by degrees to tolerance of a higher and higher level of unemployment.

This is not an unfair criticism. In 1961, the Council of Economic Advisers said we want to get unemployment down to 4 percent by 1962. In 1962, they said we want to get unemployment to 4 percent by 1964. In 1964, they said we hope to get unemployment to 4 percent by 1966. In 1965, the Council is saying we don't expect to get unemployment to 4 percent in any time in the foreseeable future, and certainly we are not trying to do it next year. So we are gradually tolerating a higher and higher level of unemployment.

I do firmly expect unemployment to get higher if and when we run into the next even mild economic downturn, because this is the record of the last 11 or 12 years, that each recession has brought unemployment higher than before, and each recovery has left unemployment higher than at the peak of the previous recovery.

In this respect, this longest recovery on record has not changed the record one iota. It has been more durable, but not more successful in reducing unemployment. If we have a growth rate of 4 percent, we will run into a much higher rate of unemployment than now, and run into cumulative pressures on the economy which will convert the inadequate rate of economic growth now into a recession.

Senator JORDAN. What percent do you believe is an irreducible percentage of unemployment?

Mr. KEYSERLING. Under the Herculean measures of wartime, we got it down to less than 1 percent, under forced draft. But I don't believe it should be that low. I think it should be under 3 percent, on a full-time basis, and 4 percent on a true basis.

It is now 5, or 8 depending on how you measure it. Even at 5 percent, that is 66⅔ percent above 3 percent.

Senator JORDAN. Do you expect that wages going up might do away with some of the moonlighting, where people hold two jobs?

Mr. KEYSERLING. I am not concentrating on wages going up exclusively. I am talking about an overall economic policy, with many components. I am merely identifying the wage policy as one of the components about which I think some of the analysis is faulty. As to moonlighting, I have a curious view on that.

You know we get into many inconsistencies. We talk about American initiative, and people wanting to better themselves. We really, in one sense, ought to applaud the fellow who is so ambitious that he is willing to work day and night. We ought to live in a sensible

economy where, due to sensible policies, if there are people willing to work day and night, the economy would be that much richer and more productive.

There are enough unneeded jobs to do. Our reaction to people working day and night or having two jobs is really like the shorter workweek, our reaction to the fact that we don't seem to have the brains to realize that real wealth is in production and we ought to be able to use it.

Secondly, I would say that quantitatively the amount of job components created by the moonlighting is very small relative to the size of the unemployment problem. Of course, I would rather have two men have a full-time job than to have one man have no job and the other man have two jobs. I don't think you can stop it by trying to stop moonlighting. I think you can stop it by creating an economic environment in which there is a demand for labor. I think a society in which there is full demand for labor is ultimately good.

It means that a person who wants to work and be creative will make a contribution to society and be rewarded for it. I think that is good.

Senator JORDAN. I am pleased to hear you say that because I would hate to see the time come when a man who is aggressive and wants to get ahead could not carry on as many jobs as he is capable of performing. So I agree with you in that respect. Now you have been highly critical of the application of fiscal policies and monetary policies of not only this administration but prior administrations, and you have said that they have been working in reverse of the goal which you hope we might achieve.

One might expect, and you partially answered it, that the antithesis of that would be higher taxes on business, which you partially answered, and lower interest rates, that they might accomplish your objective.

Mr. KEYSERLING. Starting from where we are now, because we cannot reverse the past, the principles that I would submit now, Senator, are these:

Because we have already gone so far with tax reductions, we should be awfully wary of it in the future, in the near future. I mean, everything else being equal, tax reduction is always stimulatory, everybody likes it, you get a big consensus for it, but it reaches the point where it is no longer responsible.

All I am saying is that, no matter what kind of tax reduction we are talking about, we should look at it with a jaundiced eye now, because we have done so much of it already.

Maybe some kind of excise tax cuts would not be bad, provided they concentrated heavily on excise taxes on necessities and not on luxuries.

That might be all right. Certainly, I would not go in for more hundreds of billions of dollars of depreciation allowances. I would not be talking about a 5-percent across-the-board income tax cut if we should get into a little more economic trouble, because a 5-percent across-the-board cut would be extremely regressive.

So I think we should be very wary about more tax reductions. We have really given it quite a spin. Let us see how it works out, instead of swallowing all these quick claims that it has been so successful.

Second, as the current tax structure yields more and more revenues, as the economy grows, I make no apology for my view that a larger part of these additional revenues should be spent for what the Nation

needs, rather than given out in more tax reduction which will either not be spent or be spent for what the Nation does not need.

I don't apologize about that. I think we need the rebuilding of our cities more than we need high-income people to get more tax cuts to take another trip to Europe, and more than corporations need tax cuts. So I would make a different divvy between more spending as revenues grow and tax cuts, rather than relying so heavily on tax cuts.

As to money policy, the interest rate is a derivative mainly of the rate of credit expansion. I think that, while the Federal Reserve Board has yielded a little more on this than it did before, that nonetheless our basic policy of monetary expansion will not support an adequate rate of economic growth.

Therefore, I would encourage a more liberal money policy. This would have, as a byproduct, lower interest rates, which I think are now much too high, and much too much of a burden on the plain people. I do not believe in an independent Federal Reserve System. I think it is ridiculous to argue that those who manage our money should be independent.

First of all, we don't say, because taxes should not be political, that we should entrust the imposition of taxes to an independent committee of bankers in New York, or an independent committee of professors. We say just the reverse, that because taxes are so important, they must be a public responsibility.

We didn't, during the war, say that, because we were telling every worker what wage to take, and every business what price to charge, that in order to make this nonpolitical we should turn it over to a group of open-market bankers in New York. I think, fundamentally, the creation of money is a public function and not a private function, and should be closely allied with our general national economic policies, including tax policies and other policies.

We can't have that close alliance, if the FRB free-wheels independently. I think for the Chairman of the Federal Reserve Board to be able to come up here and say categorically, as a Sword of Damocles hanging over the head of the economy, that he may decide to have a different policy from the efforts made by the President and the Congress to move in a given direction, I don't think this is healthy.

I don't think that the Open Market Committee is so wise and so just and so public spirited that it should have that amount of power.

Senator JORDAN. Thank you. Now on another matter there came across my desk yesterday this news release from the Department of Labor indicating that the Consumer Price Index for January 1965 is now 108.9 over the 1957–59 average. We all know that most of the income of low-income people goes for consumer goods and this inflationary trend in consumer prices adds materially to the problems of the low-income people of the country.

Are you afraid of inflation, Dr. Keyserling?

Dr. KEYSERLING. I am opposed to it. I am not afraid of it, only in the sense that I do not think, looking over the last few years, that the amount of price increases that we have had are alarming or dangerous.

Compared with other countries, or compared with past experience in the United States, or compared with the price that we would have to pay for price controls, I do not regard the price trends of the last few

years as one—let us put it this way, I don't regard it as one of our outstanding or main domestic economic problems.

Senator JORDAN. You would be content with something around 2 percent a year?

Dr. KEYSERLING. No, we have not had 2 percent a year. That would be much too high.

Senator JORDAN. We have had 1 percent a year?

Mr. KEYSERLING. The difference between 1 percent and 2 percent is a hundred percent. We are dealing with little percentages but there is a big difference between 1 and 2 percent a year. This is a matter of degree.

Senator JORDAN. Thank you.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Dr. Keyserling, yesterday our colleague, Senator Proxmire, was having a colloquy with a witness from an independent branch of the Government and Senator Proxmire asked the witness whether trying to reduce our present 5-percent unemployment by increasing demand would be likely to be inflationary. The witness thought yes, it would. Then the witness went on to say—

> I also think * * * that where you use credit to pump up aggregate demand unduly you frequently get people to work in jobs that are not going to be satisfactory to them very long or that will really contribute to their well-being. They will be in the sort of job that the first time there is a little ferment in the economy they will be the first people to be let go.
>
> You have to get them to be trained and skilled and educated and acclimated into something that is better than just jobs created by aggregate demand when you have a credit situation that is just forcing the creation of semispeculative ventures.

Would you care to comment on that view?

Mr. KEYSERLING. Well, the independent witness said a mouthful. It is not very surprising, what he said. I have been protesting all my adult life against the proposition that, even if we assume that less than 5 percent unemployment—which is very very high for all the reasons I have given, especially because it hits so many people to the tune of 15 or 20 percent—even if we assume that a lower rate of unemployment would be inflationary, then I say that the benefits that I derive from having to pay a little less when I buy things should not be paid for by the victims of unemployment.

In other words, I do not agree that we should have 4 or 5 or 6 million people in the United States deprived of jobs, deprived of hope, in order to help those of us at the top to pay a little less for what we buy. If that were the true alternative, I would most strenuously object to the views of the witness whom you quote. I say, please find a better solution. Don't tell the young children or the Negroes on the streets of New York that "Of course, I am very unhappy about you, but after all you are protecting me, so I don't have to pay quite as much as I otherwise might when I buy a Lincoln car." I don't like that approach.

Second, I don't agree with the whole thesis that a lower rate of unemployment, on a sustained sensible basis, would be more inflationary. I have already cited some of the reasons why I don't agree with it; namely that empirically, short of the hyperinflation of wartime, when unemployment was less than 1 percent, and when there were a lot of other causes of inflation during wartime. Short of that, I find no

empirical support for the proposition that sustained 3-percent unemployment with a 5- or 6-percent economic growth rate is more inflationary than sustained 5 to 8 percent unemployment with a 3 or 4 percent economic growth rate, in the longrun.

I don't find empirical support for the claims of the independent witnesses that a higher rate of unemployment, and a lower rate of growth, is inflationary. Nor do I find, and this is my final point, nor do I find any justification in logic or social thinking for the proposition that a rise in the income of a depressed farmer is inflationary, that a rise in the income of a worker who gets less than a dollar an hour is inflationary, that a rise in the social security benefits of 16 million people, 11 million of whom live in poverty, is inflationary, but that a rise in the cost of the most common commodity of all; namely money, is noninflationary. This is a hoax.

The cost of money enters into everything. How is it noninflationary to have the Government paying out $6 billion more in interest charges than it would be paying if interest rates were lower?

How is it noninflationary for those who add business costs to their prices to be paying higher interest rates? How is it noninflationary for the wage earner, who we say is asking for higher wages, how is it noninflationary for him to pay in effect a 40 to 60 percent higher interest charge on his house than a few years ago, a 30 to 50 percent higher interest charge on the icebox he buys.

Why is it that this particular cost can go up and up, and those who are managing the spiral tell us this is the way to fight inflation?

Mr. VOORHIS. Congressman, could I say one word?

Representative REUSS. Yes; and then I want to ask you a question.

Mr. VOORHIS. The whole purpose of the third section of my testimony was to make the point that Mr. Keyserling just made, that actually the rate of interest enters into every single cost item.

And to think that you are going to control inflation by higher interest rates is ridiculous. The second point I would like to make on this is that if you reduced unemployment and increased gross national product and the flow of goods, that this is the one most constructive way to prevent inflation rather than to reduce the monetary supply.

The inflation is the relationship between effective demand on the one hand and the flow of goods upon the other. If you are really worried about it and you increase the flow of goods this is a good way to solve the problem. The other one is a bad way.

But finally I would like to point out that the Federal Reserve has all the authority it needs to control inflation any time it wants to by simply increasing the reserves in the banking system and that this is the right way to do it if it is necessary to do it rather than to raise interest rates.

Representative REUSS. In this connection, Mr. Voorhis, I would like to ask you about a part of your presentation which puzzles me a little. You seem to be saying in your statement that the only way to increase the money supply is by increasing the deficit and the national debt. If that is what you were saying, it puzzles me, because I would have thought that the money supply can be increased, with a balanced budget and no increase in the national debt, by the Federal Reserve either purchasing more securities in the open market or lowering the reserve requirements of the banking system.

Mr. VOORHIS. Congressman, I hope that a more careful reading of my statement will make it clear that I was saying quite the opposite. What I said was that the way we would do it now, the only way we get an increase in the monetary supply is by increasing debt.

This is wrong, quite wrong, to take this position that we call this need for additional flow of money a debt on the part of our Nation, when we should call it a credit instead. And that the proper way to get an expansion of the monetary supply is not by increasing debt but by using one of the methods that you just suggested yourself.

This is one of our main problems, we think we can't do the things that Mr. Keyserling has been talking about because we don't have money enough to do it. I think that one of the main reasons we think this way is because at present we derive our increases in monetary supply primarily by increasing debt which I think is wrong.

Representative REUSS. Thank you for straightening out my misunderstanding.

Now I think I have time for one more question which I would like to ask of Mr. Keyserling.

There is much talk nowadays, and I am thinking of a paper put out by, I believe it was the Center for Democratic Studies at Santa Barbara not so long ago, to the effect that we are now producing about all the goods and services that people need, and that we soon will be able to solve our problem of production and, therefore, we should get ready quite soon for a system in which a large part of the population will not be able to have the jobs which today provide the linkage to a standard of living.

I may be doing an injustice in my description of this particular paper but this idea is being floated. What do you have to say about that? Do you think our problem for the next 20 years, that being the foreseeable future, is one of finding substitutes for jobs for people or is it one of finding jobs for people?

What do you think of the social implications of this whole discussion?

Mr. KEYSERLING. I think it is a monstrous idea. I could never understand, and this started with a friend of mine who wrote a popular book, I never could understand the college professor, and I am not attempting to guess any particular person's income— a college professor who gets paid $20,000 a year by his university and earns $20,000 a year consulting, he has an income of $40,000 a year, and he goes around talking about an affluent society when half of the people of America are below $6,000 or below $7,000 and when even the family in a city with several children, with an income of $7,000 or $8,000 or $10,000, which really is way up there in the top brackets on a statistical basis, even such a family has a hard time making ends meet, and cannot afford to send two children to college if they have to pay for it.

So why all this talk about our needs being surfeited? If we set about to bring the 34 million poor up to an American standard of living—and an American standard of living is not just above $3,000, that is just above the poverty ceiling—if we took the 77 million Americans who are below what any social agency defines as a minimum really decent budget for most of the areas of our country, if we just undertook through more production and a sensible distribution and

the opportunity to work, including the training for work when it is needed, to bring them up to an American standard of living, to bring our old people up to an American standard of living, to bring our housing supply to an American standard of living, to bring our education to an American standard of living, to bring education to an American standard of education, to provide health service to our people, and to provide income gains all along the line—if we set about to do these things, we have enough needs in the United States, not talking about the rest of the world, to use all our resources fully for the next 20, 30, 50 years. Beyond that I can't see.

Besides all this I don't think that supported idleness is a substitute for the chance to be useful in an accredited way, and I don't follow the fuzzy argument of some of these philosophers that, after all, we have to think of usefulness in new terms, maybe a man wants to be a violinist, maybe he wants to sit and read, and so forth.

If a man wants to be a violinist, he can be a violinist, so long as there is demand for this. I was on the platform with one of these new philosophers. To show you how far they go, he said within 10 years 90 percent of our people won't be able to have jobs, and the other 10 percent are going to have to support them with an American standard of living through payments.

When I said, would it not be better to have some programs to have people employed, rebuilding our cities and other things, he said, "But that is not politically feasible. Congress is not ready to do it." I said, "Do you think it is politically feasible to have 10 percent of the people as a matter of national policy saying to the other 90 percent, we respect your right to sit home and read a book or play the violin or think about the world, and this is a new concept, a new concept of work, and we will give you money so that you will be able to do that."

I think the whole thing is preposterous, and very tragic. If we don't get better solutions, more and more people are going to be drawn to this snare and delusion. I found a lot of the poor illiterate people in some of the cities where I talk, being drawn to this. They say, "Amen, Brother." Of course, if they can't get jobs or food or housing, and nobody is doing anything to get it for them, why would they not be appealed to by the payment-for-nothing idea, that you are a human being, you were born, you have a right to be supported, why should not the Government just support you?

Representative REUSS. Do you think as a political proposition the 90 percent might be for it but the 10 percent would not vote for it?

Mr. KEYSERLING. I don't think, as a political proposition, the 90 percent would be for it, because we would never get to the stage where there would be 90 percent being supported for doing nothing.

If we start by assuming we already have this, it would worry me still more. If we started with the idea that 90 percent would do nothing and the 10 percent would support them, the 90 percent might be for it, but that is one of the things that worries me about it.

Chairman PATMAN. Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much. I wish to say I did enjoy your statement. I particularly would like to say to you, Mr. Keyserling, I asked two administration witnesses if they did not feel that the tax cut by creating additional bank deposits and cutting taxes at the upper level had not helped create the balance-of-payments problem. Both witnesses categorically denied it.

Now, I would like to ask you if we are to continue with tax cuts to stimulate the economy, would you care to say what you thought about a suspension of the Employees' Social Security Act, for a year, as opposed to a percentage tax reduction in income?

Mr. KEYSERLING. When you say, if we are to continue with tax cuts, you are making an assumption contrary to my whole line of advice.

Representative GRIFFITHS. I realize that.

Mr. KEYSERLING. I would say that, certainly, a modification of the regressive payroll tax would be much better for the economy than a further lightening of the tax burden on those who are not really shouldering their share of taxation now. When one asks, where will the money come from to make more social security payments without more payroll taxes, this gets to the general question of deficit financing.

This is a big subject, because the whole concept of an actuarial insurance system to support a public system of social security is a ridiculous analogy to a private insurance company.

We don't save for the future in that sense. The 20 million people, 20 or more million people, who will be old 10 or 15 years from now, and who will be receiving through public policy an allocation of the national product, will be consuming the national product of 10 or 15 years from now. The food they are eating, the housing they are living in, the clothes they wear, will be abstracted from current production at that time.

We don't save for that in the sense of building reserves up in account books. We should be supporting the social security system on a current basis out of current revenues. In other words, we should not be frozen enduringly into a payroll tax method, which I think is regressive because the employee's side is paid out of wages and the other side of it is added to business costs and paid by the consumer.

So I would say that we should make a long-range budget of how much we want to allocate to the care of our old people in the years ahead based upon economic analysis. In an $800 billion economy here is what portion of it should flow to these old people.

Set that up on a long-range basis and then finance it as we go along. I realize that because of what we are frozen in with now you can't make a transition to that. I think any step in that direction is economically and socially a helpful step.

Representative GRIFFITHS. Thank you very much. At the present time we have up for consideration taxing the tips that people draw. Now, in the matter of those who wait on tables, two-thirds of those who wait on tables are women. I believe Mrs. Keyserling points out that women are poorest of any people in the economy.

It is my opinion that as that tax goes on those women not only is that regressive but due to the social security system very few of them will ever realize an independent return on that tax. They are paying that in for the benefit of people other than themselves.

During the war I was a purchaser for the Army. I would like to comment on this business of the war employed. One of the reasons that everybody was employed, at least in the area where I was, was that the Government first paid the bill, paid the wage, but secondly

the return to the manufacturer was enhanced by every cost that was added.

So that he was rewarded for hoarding labor and he did hoard labor. There were many people in plants who were absolutely doing nothing. Now if we could pay that kind of subsidy then, what about some kind of subsidy now for those who pick up these young men and women who have no skills and help train them?

Mr. KEYSERLING. I am in favor of those kinds of expenditures, provided they are wisely used, and directed to constructive purposes.

Representative GRIFFITHS. Would you care to comment, Mr. Voorhis?

Mr. VOORHIS. Yes; I think this could be done. I think one of the best ways it could be done would be to provide funds which might indeed be spent through business organizations with some control over it whereby they would train for their own employment people whom they would then undertake to employ.

Representative GRIFFITHS. Would you say it should be done by the payout of an amount of money from the Federal Government or should it be done by tax reduction for those people?

Mr. KEYSERLING. I don't know how much room there is for a tax reduction applied to those people, because they are at income levels now where they pay practically no taxes. I am in favor of consideration of a general nationwide system of family allowances of one kind or another for low-income people, which most other industrial countries have.

I don't like the classification of need on the basis of age alone. Now, medicare is a fine thing. A man of 40 is less likely to have a catastrophic illness than a man of 66. But if a man of 40 does have it, and he sometimes has, he has more children to support than the man of 66, and he has no social security benefits. So in a sense, it is inconsistent to say we will help the old man if he gets sick but the middle-aged man we will not help.

I think we should put it on the generalized and universal basis.

Representative GRIFFITHS. A man who is a juvenile judge in the city from which I have come has tried very hard to get employers to employ children who are having great difficulty. He did secure some employment for them. Finally the employers said, "We just can't afford to do it. It is so costly to us to do it that we just can't hire people who are incompetent."

And yet that experience it seems to me would be better for the person than almost any other experience that could be given. Therefore, in some way if you subsidized such employment I don't see that it is any different than wartime.

Mr. VOORHIS. I think for that kind of young people that a first answer at least is a very much larger Job Corps program than what is provided now. I think that is a first answer. I don't know what percentage of those young people are actually troublesome ones who are given a decent opportunity. I think this is another factor.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. Thank you, gentlemen, very much for your testimony.

You have certainly given us a lot of information which we value. It will be given careful consideration. We appreciate your answers to

the questions which the members have propounded to you. I assume this will end our public testimony on the Economic Report.

We will get up the report right away and submit it to all the members and have a meeting.

Thank you very much, gentlemen, for your attendance.

Without objection we will stand in recess subject to call of the Chair.

(Whereupon, at 12:05 p.m., the committee recessed, subject to call of the Chair.)

ADDITIONAL EXHIBITS

I

(The following was made a part of the record at the request of Senator Paul H. Douglas:)

Plan To Increase International Monetary Liquidity

(By Sir Roy Harrod)

This memorandum is based on the assumption that there is a problem of international liquidity, present or to come. The prevailing official opinion appears to be that there is no such problem now, but that there is the possibility of one arising later, when the U.S. external deficit is reduced and the increase in externally held dollar balances abates. There are some, indeed, who hold that even this development would not lead to any problem, but they are in a minority.

If there is any substantial probability that a problem may arise in due course, it is not too early to consider what should be done. The process of evolving a sound scheme would necessarily take time, as would also getting agreement for it.

I hold that there is already a serious problem of liquidity shortage, but the merits of this scheme should be judged quite independently of whether this view is true or false. The scheme should be taken to stand on its own merits as one for increasing liquidity.

I will not encumber this memorandum with an extensive account of the reasons for holding there is already a problem; these have been set out in other pages. I will mention only three reasons very briefly.

1. The sufficiency of reserves overall should presumably be judged in relation to the flow of international trade and investment. The swings in the balance of any particular country, upward or downward, will presumably be in rough proportion to the total value of its external trade and investment. The ratio of liquid reserves held by the monetary authorities in the world to the total flow of world trade is now only 42 percent what it was before World War II. The experts who prepared the scheme passed at Bretton Woods believed that there had not been sufficient liquidity before the war to sustain a system of unrestrained multilateral world trade. It was certainly one of the principal objects of the plan for the International Monetary Fund to increase the quantum of reserves for international settlement above the prewar level.

It is argued that a comparison between two periods does not provide a decisive test of the sufficiency or insufficiency of reserves. That is obviously true. Many considerations have to be taken into account. But surely such a comparison gives a prima facie case for consideration. If world reserves have sunk to less than half, as they have, no reasonable man would deny that the question whether this may have an evil effect should be carefully examined.

2. There is one important reason for holding that we now need reserves in larger proportion to the flow of trade than we did before the war. Most countries now subscribe to the policy of maintaining full employment. Adherence to such a policy deprives the economic authorities of each country of the principal weapon that was used for many generations for keeping swings in the external balance of payments within bounds. If a balance went wrong, then it was considered incumbent upon the authorities to take some deflationary measures to get it straight. This was, far and away, the most powerful remedy for a deficit. In the days before such a policy was accepted as a regular rule of action, a similar effect was produced by the automatic working of the gold standard (old style).

It is not here denied that if an external deficit is accompanied by international inflationary pressure, measures of deflation ought to be adopted. That indeed should be a golden rule. But external deficits are not regularly accompanied by over-full domestic demand and inflationary pressure; on the contrary they are

equally often accompanied by under-full employment and stagnation or recession in the domestic economy. If the authorities are deprived of their prime weapon for curing an external deficit, then it would seem that the deficits will have to be corrected more slowly; and consequently larger reserves will be needed to tide over the periods of deficit. Further to this, it has been an objective of policy since the war to limit the use of ad hoc import restrictions to the greatest possible extent. Although before 1914 import restriction was not a regular method of curing a deficit, it had come to be increasingly used, along with allied restrictive practices, in the interwar period. At present it is hardly to be expected that developing countries will not continue to have to rely on such methods. The hope is that the industrial countries will resort to them as seldom as possible.

Thus the authorities are deprived of the two most powerful weapons of dealing with the problem of a deficit. The consequence is that, if the objectives of full employment and unrestrictive trade are to be realized, we shall have to rely on more slow-working methods, such as wage restraint. This points to the need for a higher ratio of reserves to international trade.

3. What has been proceeding in the last 4 years seems to indicate that a liquidity shortage already exists. We have had all sorts of special arrangements. Of these the most prominent has been the willingness of central banks to hold dollar balances in excess of their normal requirements. There have been other special arrangements more recently, including swap agreements, the conversion of dollar balances into medium term U.S. obligations denominated in the currencies of the countries holding the balances, the "Basel agreement," etc. All these arrangements have been excellent. Nothing here said is intended to disparage them. But they carry the hallmark of being provisional and ad hoc. Why were they necessary, if the normal system for settling balances was working efficiently? Some of these arrangements have not only been special, but often also hurried. Huge sums have been involved, amounting to many billions of dollars, if we include the abnormal dollar holdings of certain central banks. All of these are admirable arrangements, and all praise should be given to those responsible for them; but the fact that they had to be made is a symptom of something wrong.

The only answer to this third point would be if it could be shown that the dollar deficit was something altogether abnormal. But the main part of that deficit arose because private American citizens chose to invest some 0.6 percent of their incomes abroad, instead of, as in the preceding years, some 0.3 percent. There is nothing extraordinary about that. The change may have been partly due to a more outwardly looking attitude on the part of American investors and partly to other countries having come to appreciate better the facilities of the New York capital market. What, it may be asked, should the American authorities have done when this change occurred? Anyone can see that they have not pursued inflationary policies in the last 5 years. Should they have imposed import restrictions promptly, or taken some other form of unneighborly action? Surely the Americans have been wise and far-sighted and good neighbors in allowing time for their deficit to get cured by more slow-working forces.

It is true that the American deficit is particularly noticeable, because the United States is a very big country. But it is no more serious in economic terms than if five countries, each with one-fifth of the foreign trade of the United States had proportional deficits simultaneously. I believe that those who made the special arrangements referred to above themselves recognize that they cannot be regarded as constituting a permanent system. Some hold that there should be a more systematic, firm, and durable plan for mutual accommodation between the central banks. Some hold that such arrangements should be channeled through the International Monetary Fund. In the British case, when in 1961 special arrangements were made for other central banks to support sterling, it was strongly hinted that the British might think of transferring their indebtedness to the International Monetary Fund. And this was in due course done. The essence of what follows might be described as an essay on how this could be done through the IMF more systematically.

Before proceeding, two further points may be noted. There are some who hold that there would be enough liquidity in all, if only what exists were better distributed. It cannot be stressed too much that in a properly working system liquidity would always be maldistributed. Liquidity exists to be used, and not for mere ornament. If a nation is using its liquidity to tide over a period of deficit, then at the end of that period it is necessary that the total of world liquidity should be maldistributed. Then some other nations may get ino difficulties, and, if they use their liquidity, they will thereafter have less than a

proportionate supply of it. If one made it a rule that arrangements should be such that liquidity was never maldistributed, then there would be no liquidity at all, because any use of reserves would lead to a maldistribution. So-called maldistributions, i.e., uneven distributions—are a sign that the system is working as it is meant to. Maldistributions are likely to be especially prominent if there is an overall shortage, because the proportion of total liquidity actually used by a nation to tide over a deficit will be a larger proportion of total liquidity than it would be if total liquidity were greater.

The second point concerns "discipline." It is held that, if liquidity were increased, there would be a relaxation of discipline, and that it is better to keep everyone on a tight shoestring. This point of view is erroneous. Anyone who knows anything about discipline, such as an Army officer, knows that the best way to get good discipline is not to make everything as difficult as possible. Let there be moderate, but not excessive, austerity. One might cite an example from the common experience of people through the ages. If it is necessary for a breadwinner to make an allowance to a son, say during his university career, or to any dependent, it is best to think out carefully and provide what it is reasonable to expect that he will require. If the dependent is kept on too tight a shoestring, so that it is humanly certain that he will have to ask for more, laxity at once sets in. The dependent argues, "If I have to go back and ask for an extra $500, why should not I show cause for needing an extra $1,000?" But if the donor works out carefully what will reasonably be required and puts it to the dependent as a point of honor that he must do with that, then the dependent is more likely to make a great effort not to have to ask for more.

Before proceeding to explain my plan, I must make one proviso. For many years I have argued that the initial solution to this problem should be a rise in the price of gold in terms of the dollar, and in terms of other currencies also. Such an increase would be a first step and provide a firm foundation for other reforms, which might, despite the change in the gold price, still be desirable. I believe that this would be the simplest initial solution, and is also due as a point of honor. But at the present time study groups are working on schemes, subject to the condition that they should not discuss a change in the price of gold, and it is hoped that they will produce some workable plan before the meeting of the IMF in Tokyo. It accordingly seems right that I should subject myself, for the time being, to this same condition.

Plan

I. DRAWING RIGHTS

I propose, first, that members of the IMF should be entitled to utilize their existing drawing rights at their own discretion and when they please without prior consultation. This recipe has already often been proposed. The change of procedure could be made without any change in the Articles of Agreement of the International Monetary Fund. This change would, in my opinion, make a very big difference and bring about a substantial increase in liquidity.

Liquidity cannot be defined without reference to psychology. A man is liquid if he feels liquid. Take the case of a man who has it in mind to add a new unit to his factory. He may protest that he does not wish to do so because he has not the liquid resources. One may say to him, "You know perfectly well that, if you go to your bank manager and talk to him and show him the condition of your assets, and so forth, he will be perfectly ready to lend you $100,000." That may be the case; but the man does not feel at all the same way about his position as he would if he had $100,000 in the bank or in some portfolio securities that could be readily sold without loss. He may well say, "No, I do not want to go to the bank; I shall choose to wait until my own business is more liquid"; and so he may postpone ordering the extra unit, if the matter is not urgent. Similarly a central bank may decide in the face of a balance-of-payments deficit to impose some deflationary measure even though this is not required by the state of domestic economy, rather than go through consultations with the IMF. The central bank would feel quite differently, if it were merely a question of drawing a check upon its balance there. Furthermore, the publicity involved in the drawing, when it occurs, under the present system may entail a loss of confidence in the currency concerned. This may have adverse effects and partly offset the value of the drawing.

I may be allowed to mention that I had frequent discussions with the late Lord Keynes when he was drafting his plan prior to Bretton Woods, and during the discussions of the counter plan put forward by the Americans. I am convinced that, when he agreed to the constitution of the IMF and recommended it to the British Parliament in a speech that won many votes, it never entered his mind, right up to his death,[1] that the drawing rights would not be useable by the members without question or prior discussion. His view on this may be held to have some weight, since he can be regarded as a cofounder of the International Monetary Fund.

I suggest that the amounts of unexpended drawing rights as existing at the time of the coming into existence of the new plan, should be called "deposits"; any further drawing rights arising in due course in whatever way should likewise be called "deposit." This change of name could have a profound psychological effect and influence policy. Any central bank would then be able to write a check upon the International Monetary Fund at any time at its own discretion up to the amount of its own outstanding deposit.

Be it noted that, at the time when the central bank was writing out its check, no one would know that it was doing so. Thus there would be no public impact, possibly resulting in a loss of confidence, at the time at which the "drawing right" was exercised. This in itself would be a gain.

Doubtless the IMF would publish, as now, the outstanding condition of member balances periodically. But this would be after the event. If the need to draw was determined by a crisis of confidence in a currency, the crisis might have blown over before the drawing was publicly known. I understand that this has been an advantage pertaining to some of the recent special arrangements (swaps, etc.), and that this may have been a reason for their being preferred by central bankers to a more publicly bruited use of the general arrangement for borrowing or, indeed, to ordinary drawings on the IMF.

I believe that it would be convenient to have deposits denominated in the currency of the country owning them.

It might be argued that this scheme would deprive us of the advantage of having "consultations" prior to drawings. The advantage of consultations as such may indeed be recognized. But there would be no need to discontinue regular annual consultations, such as were started in connection with article XIV, and, it is understood, are still continuing with countries that have come under article VIII. There would also be occasions on this plan for special consultations, to be described in section VI below. There are disadvantages in having consultations too closely related to a particular crisis in which a drawing may be required. There may be insufficient time for mature consideration, and action may be taken in consequence of the consultation, which would be seen on a longer view, and without the pressure of the existing crisis, to be inappropriate.

II. DEPOSITS AS INTERNATIONAL LEGAL TENDER

I propose that checks drawn upon the IMF in accordance with the above should be accepted by all central banks of member countries without question, so long as the drawer is entitled by his deposit with the IMF to draw the check. Deposits at the IMF should constitute what may be called international legal tender.

The procedure would be as follows. Let it be supposed that the British authorities need to support sterling against the dollar in the London foreign exchange market, in order to prevent sterling falling below the lower point allowed, in accordance with article IV, section 4(B) of the articles of agreement. For this purpose the Bank of England needs dollars, which it can acquire by reason of its deposit at the IMF. The Bank of England would write a check, say for $280 million, on the IMF in favor of the Federal Reserve, which the Federal Reserve would accept without question. The Bank of England would thereby acquire a dollar deposit which it could use to support sterling in the London market.

The reason why it is expedient that the deposit of the Bank of England in the IMF should be denominated in sterling, is that it cannot be foreseen in advance which currency the bank will need, in order to maintain orderly conditions in the London market. It would be of the essence of a deposit with the IMF that it would entitle its holder to draw a check in the currency of any

[1] Or, at least until the IMF meeting at Savannah (March 1946), a month before his death.

member country; thus such a deposit would be equal, as regards liquidity, to gold, which can be used in the market to buy any currency. Let us examine the position from the points of view of the three parties affected.

The liability of the IMF to the Federal Reserve would be increased by $280 million, while at the same time its liability to the Bank of England would be reduced by the equivalent in sterling, viz. £100 million. (Be it noted that the acquisition of dollars by the Bank of England would not involve any operation passing through a foreign exchange market; the conversion of sterling into dollars would be executed solely on the ledgers of the IMF. The above example implies that the conversion is made at the parity rate. It might be more expedient to make it at the rate ruling in the foreign exchange market of the paying country.) The operation would not affect the size of the total liabilities of the IMF. These would be equal in amount to the sum of all quotas, and would constitute a closed circuit from which there could be no leakage.

The Federal Reserve would have an increase in its deposit at the IMF and an increase in its deposit liability, which might in the first instance be to the Bank of England—unless the Federal Reserve immediately gave a check to the Bank of England drawn on some other American Bank—but would, in any case, eventually be a liability to an American member bank, as and when the Bank of England used its dollars in the market.

If the Federal Reserve disliked the increase of liquidity in the U.S. economy, created by the increase in the deposits of member banks with it, it could offset this by selling bills or bonds of equivalent value in the open market. The problem for the Federal Reserve would be precisely the same as if $280 million worth of gold had come into the country. The initial increase in domestic liquidity is the inevitable effect of having a favorable external balance of payments.

For the Bank of England the result would be a reduction in its reserve in the form of its deposit with the IMF—the unfortunate consequence of having an unfavorable balance of payments. Under the existing British system any loss of reserve is initially offset by an increased holding of "tap" Treasury bills by the exchange equalization account. Thus the monetary authorities would have exchanged a deposit at the IMF for a holding of British Government securities of equal amount. It would then be open to the Bank of England to make an independent decision as to whether the state of the domestic economy, as well as that of the external balance, called for some measure of net deflation (reduction of the domestic money supply), which it could execute by open market sales of government securities.

An illustration has been given from a transaction between the United States and the United Kingdom. All that has been said would apply equally to any pair of member countries.

It might be objected that this proposal in effect revives a feature in the original Keynes plan to which the American authorities took exception in 1943. But I believe that the position has changed since then. Incidentally it should be noted that this scheme does not involve the introduction of Bancor, IMF units, or any kind of fresh currency whatever.

The American objection was that, if all other member countries were debtors and only the United States a creditor in the international balance of payments, —to take an extreme case—the United States would get a piling up of claims upon the IMF equal to the full total of all the quotas of all the other members. They held that this would constitute a gigantic handout, and would be more than they could be expected to agree to. Other countries might well feel the same way. But now the two following points could be pleaded:

1. It should be clear that a deposit at the IMF, which can be converted into the currency of any member country, is to all intents and purposes as good a form of reserve as gold. What could gold do that such a deposit could not do? There is of course the question of goldsmiths, but that can surely be looked after. More serious is the point that the deposit with the IMF could not be used for payments to nonmembers. The various countries will presumably continue to keep sufficient gold reserves for that particular purpose. Finally, there is the question of war. It might be felt that gold in the hand would be a better asset in such an eventuality than a deposit of equivalent amount at the IMF, the operations of which might be in part interrupted by the war.

But if this is serious consideration, and if gold is felt to be a substantially better medium of reserve than a deposit at the IMF readily convertible into any currency in the world, then surely this points to the desirability of rehabilitating gold by raising its price: i.e., restoring its commodity value to its prewar level. One cannot have it both ways. The recent trend of thought has been toward

a lessening of the importance to be attached to gold. It is asserted that it is more rational to increase the total quantum of international liquidity by some system of mutual credits—such as that outlined in this paper. We put ourselves into a hopeless position if, on the one hand, we refuse to rehabilitate gold, and on the other insist that any other medium of reserve is inferior.

2. Not long after the American negotiators rejected the clearing union plan, on the ground that it would involve too great a handout, the Americans, by great generosity, actually made a handout (Marshall aid) of far vaster dimensions than would have been involved had all members of the IMF been allowed to draw out dollars to the full amount of their quotas in 1947 and afterwards. This was lucky for the countries of Europe since, as things happened they received this great gift, instead of merely getting a credit repayable in due course. From the point of view of the United States, on the other hand, had it allowed this great accumulation of "bancor" to pile up in its favor, this would have come in useful during the recent years for the finance of its external deficit. Instead of having to obtain credit from the European countries on a large scale, it would merely have had to utilize what had accrued to it of right (bancor) in the preceding years.

Doubtless the question of Marshall aid had wider implications and must be considered in relation to special postwar circumstances. But the pattern of events since the setting up of the IMF does suggest that a nation should not be too much afraid of accumulating large amounts of credit by way of Interbank or IMF accommodation, since this is likely to come in useful at a later stage.

III. ABOLITION OF THE CURRENCY HOLDINGS OF IMF

I suggest that the national currencies now held by the IMF should be returned to their owners as no longer serving any useful purpose. This would be a mere bookkeeping operation, involving the scratching out of various figures in the ledgers of the IMF and of the central banks.

The fact that this operation could be represented as a mere paper transaction does not mean that it would do no good. It would in itself increase the psychological feeling of liquidity, and this, as noted above, could have an effect on policy; e.g., by making nations feel more willing to refrain from resorting to inappropriate deflationary or unneighborly measures. The various currencies now held by the IMF appear as liabilities in the accounts of the countries to which they belong, and make them seem to the rest of the world less liquid than they truly are. This may diminish confidence. When the quotas of the fund are increased (as in 1958), these liabilities go up.

If it is objected that the IMF should be able to show assets against all its liabilities, these currencies could be replaced by national noninterest bearing certificates of indebtedness of equivalent amount. These would be redeemable only on the winding up of the IMF or on the withdrawal of a particular country.

The idea that the IMF should hold a bagful of currencies was always an untidy one. It seems to have emanated from the brain of the late Harry White, who does not appear to have had a good feeling for the theory or practice of banking.

In recent years we have had the spectacle of the IMF deciding how much of each of the various currencies to give to a country on the occasion of its drawing. No doubt it has exerted skill in the apportionment of currencies, having regard to its own availabilities and the likely needs of the drawing country. Nonetheless this procedure, however cunningly devised, has been quite illogical, considering that these various currencies have been freely convertible into one another in foreign exchange markets. When a system necessitates a procedure, which from a wider point of view constitutes a meaningless ritual, this is surely a sign that there is something radically wrong with the system. If one probes deeply enough into the real significance of the relevant part of the constitution of IMF (notably art. V), it surely appears that, while firmly laying down that currencies shall be convertible, its mechanisms are designed for a situation in which currencies are not mutually convertible. The architects of the Fund in 1943 had not yet got back to thinking of what was required in the setting of convertible currencies.

The scarce currency clause, which has not been used, and which is not really workable in its final (as opposed to its original) form, when currencies are mutually convertible in foreign exchange markets, should be rescinded.

The general arrangements to borrow could then be rescinded. These arrangements add nothing to international liquidity, but are designed to enable the

Fund to meet its obligations in certain circumstances, and are simply another offshoot of the unhappy conception of the Fund as a bagful of currencies.

IV. IMMEDIATE INCREASE OF QUOTAS?

So far all that has been proposed has been a loosening up and a quickening of the powers lying dormant in the International Monetary Fund. Without any increase in its resources or enlargement of the domain of its authority, the streamlining proposed above would enable it to make a far greater contribution to liquidity than it now makes.

But I am not suggesting that this would be sufficient to deal with prospective problems. In my own person, I believe, for reasons outlined above, that a great increase in world liquidity is needed now. Those who do not agree with this view can ignore this paragraph. The rest of the plan is independent of it. I recommend an immediate increase of quotas of substantial amount.

V. ANNUAL INCREASE OF QUOTAS

But it will surely be agreed that we do need an annual increase of quotas. Otherwise the ratio of means of payment to the value of international trade will decline continuously, year by year; it will decline even more rapidly than it has done since the war. Is there any one so optimistic as to suppose that, despite the adverse factors mentioned above, the swings in the balances of international payments will get progressively less at an increased rate? When the United States external deficit is substantially reduced, as it already has been at the time of writing, the rate of increase in total world reserves will be much reduced.

Accordingly I suggest that an automatic annual increase of quotas should be embedded in a fresh agreement. Incidentally this was a feature of Keynes' original plan. I never heard that it was objected to on its own merits, although it may have been. I believe that it merely got lost to view and dropped out in the complicated discussions prior to Bretton Woods.

What should be the amount of the annual increase? I suggest, that, if we do not want the ratio of means of payments to transactions to drop further, the figure for the increase of total international liquidity should be 4 percent a year.

In the 7 years from 1955 to 1962 the dollar value of world imports rose by an average of 7.8 percent a year. That was partly due to inflation, which we hope will abate. Four percent seems to be a moderate figure for the increase in the flow of trade and also in current invisibles and in capital items, against all of which reserves are needed. It is to be noted that in those same 7 years monetary gold stocks increased by an average of 1.2 percent per annum only, and total liquid reserves (including IMF gold tranche positions) by an average of 2.1 percent only.

In order to get an increase of 4 percent a year in total liquidity, deposits at the IMF would have to rise at a greater rate than this.

Taking the level of existing liquidity (which, however, I personally regard as inadequate), an increase of 4 percent a year would initially mean more than $2.5 billion, per annum. Since 1955 the monetary stocks of gold have increased at the annual rate of only $500 million. (Of course, if its price were raised, gold accessions would make a much larger contribution).

I see no reason why, if the IMF were contributing a fair share toward the total increase of liquidity required, dollar and sterling balances should not also continue to increase. If a proposal made below were adopted, this could underpin the position of the dollar and sterling in such a way to make their holders feel greater confidence in them. But to ask of those two currencies that they should contribute almost the whole of the annual increase of international liquidity required is putting too great a strain upon them.

I am in disagreement with my learned and distinguished colleague in the profession of economics, Professor Triffin, in that I do not think it desirable to terminate the use of the reserve currencies (the dollar and sterling) as means of international settlement. Between them, they have actually made an absolutely vital contribution to the increase of liquidity in the last 20 years. Although there have been certain phases in which confidence has weakened, we canot deny that, by and large, the externally held balances of these currencies have served the world in good stead. To withdraw them from international circulation would be to destroy liquidity on a heroic scale. I appreciate that

Professor Triffin has proposed that the IMF should provide substitute means of payment for them. But this would be adding—wantonly, as it seems to me—to the tasks of the IMF. I do not conceive that it is beyond the bounds of possibility, though doubtless it would be very difficult, to get agreement for the modest proposal that I am making in this memorandum. I am sure that it would be far more difficult to get an agreement for that massive increase in IMF credit which would be necessary, if the IMF had to provide a substitute for the dollar and sterling balances now used as international reserves.

I suggest that the aggregate of dollar and sterling balances might be expected to increase at $1 billion per year, without any undermining of confidence in these two currencies, provided that certain things were done, as proposed in VII below, to give them support.

Incidentally such an increase would enable the United States to continue to have a deficit on its external balance, although, naturally a much more moderate one than it has been having in recent years. This might make it easier for the United States to go forward on a solvent basis without seriously injuring its other objectives of policy.

It is a paradox that a U.S. deficit benefits the rest of the world in all respects but one. The one disadvantage is that it necessitates the rest of the world holding larger balances of a particular currency than it may deem satisfactory and wise. (The same applies, of course, to a United Kingdom deficit, when one occurs). The fact that U.S. foreign investments, aid, and oversea governmental expenditures exceed its favorable current account balance has a directly stimulating effect on the economies of the rest of the world, and also serves to facilitate growth policies in other countries. If there is anything that would strengthen confidence in the dollar so as to enable the United States to continue to show moderate deficits, that would certainly be most helpful to other countries, not least the developing countries.

If we can take credit for plus $500 million per annum for gold accessions and plus $1 billion per annum from an increase in dollar and sterling balances that would leave about $1 billion of extra liquidity to be provided by the IMF, to make up the total of $2.5 billion required. This would be an increase of about 6½ percent a year on the sum total of existing quotas. At a (rather considerably) later date this rate of increase could taper off, if and when IMF deposits came to constitute a progressively larger proportion of total world liquidity.

VI. USE OF IMF GOLD

Under the above arrangements the IMF would not require any gold. The plan provides for a limited quantity of deposits at the IMF, which would circulate from central bank to central bank. These deposits would constitute a closed circuit from which there could be no leakage.

I propose that the gold in the possession of the IMF, and as subsequently added to, be used to make loans to members in special balance-of-payments difficulties. Such loans would be made after consultations and investigation and interest would be charged.

I conceive the "deposits" of members (unexpended drawing rights up to the full limit of quotas) to be an addition to international liquidity, as required to look after the ordinary chops and changes in balances of payments, such as are likely to arise in a world of more or less unrestricted international trade and investment. They should be thought of simply as gold substitutes, supplementing the value of aggregate gold reserves, which have shrunk so much. Use of these deposits should be thought of as in the ordinary run of business, just like the use of a gold reserve.

But circumstances may arise in which some members are in exceptional difficulties; e.g., when a large structural readjustment has to be made, taking a considerable time; these could be met by borrowing. (Note that the word "borrowing" should cease to be applied to the utilization by a member of its own deposit.) When there seemed to be good cause for a loan owing to special circumstances, then the whole matter should be examined carefully by the IMF, and the loan made, if it seemed justifiable.

Naturally members would not pay interest on the use of deposits, any more than any individual pays his bank interest for using his own deposit there. These loans for special occasions carrying interest would thus be a useful source of revenue for the IMF.

If there were not enough viable lending projects to utilize all the gold in the IMF, the remainder should be invested in securities. There is a precedent for this in the investment by the IMF of some of its gold in U.S. bonds.

These investments should be distributed on two criteria. 1. A preference would be given to a member in balance-of-payments difficulties. If it had a good capital market, this might be a way of helping its reserve, alternative to a loan. This criterion presumably justified the IMF purchase of U.S. bonds. But it must be noted that the investments should be more liquid (from the point of view of the IMF) than the loans, and therefore a loan, rather than an investment, shoud be regarded as the right way of meeting special balance-of-payments difficulties that seemed likely to be obdurate. (Of course an investment could be converted into a loan at a later stage.) 2. Subject to 1, the investments should be equiproportionately distributed among members. There would be an interweaving between these two criteria.

Loans and investments up to the limit of its gold holding should provide sufficient income for the IMF.

If it was not sufficient, certain service charges could be made. Under the scheme proposed there would be a far larger turnover of transactions through the books of the IMF than there is at present.

VII. THE DOLLAR AND STERLING

Criticisms have been made of the excessive use of the dollar and sterling as reserve media, sometimes called a gold exchange standard. As already stated, I am not in agreement with Professor Triffin in regarding this system as inherently unsatisfactory; it becomes so only if too much strain is placed upon the two currencies, leading to a lack of confidence in them.

The use of these two currencies as reserves arose in different ways. In the case of sterling the accrual of large sterling balances was, in by far the greater part, due to the method by which the United Kingdom financed some of its external burdens in World War II. The dollar balances arose in the first instance through the generous aid of the United States, and later through the addition of U.S. private investment overseas, direct and portfolio, aid and private investment together overtopping the amount of the U.S. favorable balance on current account.

The proposals here outlined should apply to any other currency also, if any came to be used as a reserve currency in substantial amount and for a substantial period of time. The paradox about a reserve currency is that, in order for it to acquire this status, its country has (1) to be strong and (2) to have a sizable deficit in its balance of payments. If the currency is not strong, other countries will be unwilling to hold it as a reserve. If there is no external deficit, foreign balances in the currency will just not arise.

The main objective of the proposals of this paragraph is to provide sufficient additional confidence in these currencies to make other countries desirous of holding them as reserves, of their own free will and without any pressure being put upon them to do so. They might even be encouraged, as suggested in V above, to hold them in larger quantities than at present.

There is a further objective. It is desirable that these two countries, the growth of whose economies has so important an effect on the quantum of world trade and thereby on the fortunes of developing countries, should be free to have whatever interest rates they deem most likely to be conducive to steady domestic growth at the highest potential. This objective may be impeded, if interest rates have to be kept at a higher level, as a safeguard against the withdrawal of foreign-held balances. In certain circles it is argued that these two countries should rely exclusively on the "fiscal weapon" (i.e., to put it bluntly, budget deficits) to maintain domestic expansion, this leaving them free to have whatever interest rates are needed to influence the international flow of capital. This does not chime well with the reluctance of the U.S. Congress, and indeed of U.S. public opinion generally, to envisage continuing Federal budget deficits, taking one year with another. Furthermore it may be that for a country already so well endowed with capital equipment as the United States, it may really be needful for it to have ultralow interest rates, if it is to secure an appropriate expansion of domestic investment. In the United Kingdom, interest rates have recently been very high by its historic standards; this has unquestionably been due in part to embarrassments in relation to the external sterling balances.

My proposals are as follows. For convenience, I express the matter in terms of the dollar.

(i) Establish a zero date.

(ii) At the end of 1 month establish as soon as possible—subject to difficulties of statistical compilation—(a) the size of the U.S. reserve, and (b) the size of foreign holdings of dollars, both compared with the zero date. Support would be called for only if both these magnitudes had fallen. If gold reserves fall without any fall in foreign held dollar balances, this would be a sign that the United States was in overall deficit, and that would be a matter to be dealt with differently. If foreign-held balances fall without any fall in the gold reserve, that would be a sign that the United States were in overall surplus. But if the gold reserve and foreign-held dollar balances both fall, that would be a sign that foreigners were shifting out of dollar reserves, whether because the interest differential had become unsatisfactory or owing to diminished confidence.

(iii) The IMF should then open a line of credit in favor of the United States (which should be kept distinct from the "deposit" of the United States), equal in amount to the fall in the gold reserve of the United States or the fall in the external holdings of dollars, whichever was less. Interest would be charged for any use made of this line of credit.

(iv) At the end of the second month, the status of the U.S. gold holding and foreign-held dollar balances should again be established by comparison with the zero date. (Note: not with the status at the end of the first month.) If the decline in the gold reserve and in the foreign-held dollar balances, whichever was less, was greater than at the end of the first month, the line of credit would be increased accordingly. But if the decline was less, as I conceive it well might be, owing to the confidence given by the putting into operation of this particular plan, the line of credit should be reduced accordingly. If the United States had already used so much of the line of credit granted at the end of the first month as to make this impossible, it should be obliged to repay enough to reduce the line of credit to the appropriate amount, as calculated for the end of the second month; it would repay either by drawing upon its ordinary "deposit" at the IMF or in gold.

It is to be noted that this line of credit would not increase the sum total of world liquidity (which would be determined by the principles set out in previous paragraphs), since by definition the line of credit in favor of the United States would be no greater in amount than the reduction in liquidity due to other countries having become less willing to hold dollar balances.

(v) The same procedure should be adopted at the end of every month.

(vi) At the end of the third year from zero date a different procedure should be adopted. It might well have happened, and I believe it would happen, that no line of credit would be outstanding at the end of the third year, because either the gold reserve would not be lower than at zero date or the foreign-held dollar balances would not be lower. On the contrary I believe that at least the latter would be higher, owing to greater confidence in the dollar and to the expansion of international transactions.

If the calculations showed that a line of credit was still due, and if the United States had utilized some part of it, it would be under obligation to repay at the rate of 5 percent a year over 20 years, the repayment to be by draft upon its ordinary deposit with the IMF or in gold.

This idea of a repayment of 5 percent a year on indebtedness to the IMF consequent upon its taking over of dollar (or sterling) liabilities is due to Professor Triffin. But whereas he envisaged the immediate taking over by the IMF and the subsequent redemption by the United States and the United Kingdom of all dollar and sterling balances now outstanding, which would involve a destruction of international liquidity on a heroic scale and might not be acceptable to countries which now hold dollar or sterling balances, my plan only envisages the taking over and redemption in 3 years time of that portion of the balances that, in consequence of 3 years' experience, it was found that other countries were not desirous of holding. This would be a comparatively minor operation. In my opinion there would in fact be no operation at all.

In this way I believe that the dollar and sterling could be made to play an increasing role in the provision of international liquidity, as outlined in V above.

VIII. ARTICLES OF AGREEMENT OF THE IMF

It need not be supposed that the proposals of this memo would necessitate a vast upheaval. In many respects the structure of the IMF would be left intact. But I do not think that the IMF can make a substantial contribution to an increase in international liquidity without some change in the articles of agreement. They were drafted in haste and under great pressures during wartime, when the economic shape of the postwar world could only be dimly foreseen. I am sure that their authors never thought of them as an Ark of the Covenant that should never be changed. Indeed, even if there were no problem of international liquidity, it would be desirable to set up a committee to revise some of these articles.

Recommendations IV and V above could be implemented, without any amendment, under article III, section 2, which provides for a change of quotas. Presumably this would cover a decision for a prospective annual increase of quotas of 6½ percent a year, say for a period of 10 years ahead. By a liberal interpretation, this section might conceivably also cover recommendation VII; namely, for special support to the dollar and sterling. If not, a fresh article would be needed. It could be drafted without the mention of any particular currencies, referring only to any currencies which had served as reserve currencies in substantial amount and for a substantial time.

For recommendation VI there is already a precedent in the use of IMF gold for the purchase of U.S. bonds. (I lack information about which article was deemed to authorize this purchase.)

Recommendations I–III would require some substantial changes. References in article III to the subscription of currencies should be amended to read subscription of non-interest-bearing certificates of indebtedness, payable only on the winding up of the Fund or the withdrawal of the country in question from membership.

Article V would require total reconstruction, all reference to currencies and to purchases and repurchases being deleted. Instead, we could have a short workmanlike article, constituting quotas as "deposits" and the Fund as the holder of a closed circuit of deposits from which there could be no leakage.

Article VII (scarce currency clause) would become redundant.

II

(The following material is inserted in the record at request of the minority members of the Joint Economic Committee:)

WAGES AND PRICES BY FORMULA?[1]

The intended effect: avoidance of inflation and more responsible labor-management leadership.

The likely effect: throttling of competition, drag on economic growth, and wage and price fixing.

(By Arthur F. Burns)

In recent years our Nation's economic policy has been focused largely on the problem of unemployment. The reasons for this concern are plain. The recovery from the recession of 1957–58 failed to develop momentum and came to a halt in the spring of 1960 when the unemployment rate was still above 5 percent. The new recession that followed proved to be mild and brief. But when the labor force is growing and becoming more productive, even a minor recession of business activity can have serious repercussions. In the early months of 1961, unemployment reached 7 percent, and the new administration, as was generally expected, embarked promptly on an expansive economic policy.

At first the administration placed its emphasis on increasing Federal expenditures and on creating as much monetary ease as the state of our balance of payments might allow. Later, with unemployment still hovering around 6 percent, the need for a more effective policy became clearer. Official interest gradually shifted from raising Federal expenditures to carrying out a sweeping reduction of income tax rates, which still bore the stamp of the great depression and World War II. After a protracted debate, Congress recognized the importance of revising the tax system, and lower tax rates for individuals and corporations became law. Meanwhile, the administration promulgated more liberal rules for figuring depreciation on tax returns, took some steps to improve the matching of jobs and skills in labor markets, and pressed for an extension of monetary ease.

By and large, the economy has responded well to the new direction of economic policy. Of late, production and employment have increased materially, and the unemployment rate has been moving gradually downward.

PROGRESS WITHOUT INFLATION

In pursuing its expansive economic policy, the administration has been aware of the risk that unbalanced budgets and rapid additions to the money supply may set off a new wave of inflation. That can hardly be a pleasant prospect for any government under modern conditions. The impact of inflation on the purchasing power of families living on pensions or other types of fixed income is severe. Also, inflation commonly bears harder on those who work for a salary than on wage earners, and it deals harshly with anyone whose plans for the future depend on savings accumulated in the form of bank deposits, shares of savings and loan associations, Government savings bonds, and the like. These injustices of inflation tend to breed political discontent, and so, too, does the widespread awareness that inflation is often the precursor of recessions. When costs and prices begin advancing rapidly, experience has shown that speculation in inventories and overbuilding tends to develop, that the strength of economic expansions tends to be undermined in the process, and that prosperity is then liable to give way to recession.

[1] Source: Harvard Business Review, March–April 1965, pp. 55–64.

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Moreover, the precarious condition of the balance of payments has lately added a dimension of risk to inflation that we, unlike an earlier generation of Americans, cannot ignore. Since 1958 our country has experienced a massive outflow of gold and a still larger increase in its short-term liabilities to foreigners. The United States has continued to serve as banker of the world; but any banker whose reserves dwindle while his demand liabilities keep mounting will inevitably invite caution on the part of those who deal with him.

Fortunately, our wholesale price level has recently remained stable while much of the rest of the world has suffered inflation. This development has served to keep down the deficit in our balance of payments, but it has not sufficed to eliminate it. Therefore, if our price level should rise in relation to that of competing nations, our exports would tend to diminish relative to imports. Unless major steps were taken to counteract such a development, the deficit in our international accounts would become larger, and this could lead to a run on the dollar and its ultimate devaluation. The attending financial crisis would unsettle commercial and industrial markets throughout the world. It would leave a legacy of fear that could result in a lasting constriction of international trade and investment. Worse still, it might injure fatally our country's foreign prestige and, therefore, its capacity for political leadership of the free world.

Clearly, the risks of inflation are formidable, and they are recognized as such in informed circles both within and outside Government. Thus, in formulating the Nation's economic goals, the President's Economic Report of 1962 emphasized "the achievement of full employment and sustained prosperity," and urged such an achievement "without inflation."

But how can inflation be avoided? Government authorities have approached this question pragmatically since 1960, just as they did during the 1950's and in earlier times. They have, however, made it plain that they would be disinclined, as long as the economy is still operating short of full employment, to seek general price stability by imposing monetary or fiscal restraints. And the one need that they have stressed above all others is that wages and prices be set in "responsible" fashion by private parties—in other words, that trade union leaders and business managers need to moderate their economic power in ways which will take account of the national interest in preventing inflation.

ADVENT OF GUIDEPOSTS

Exhortation with regard to prices or wages is by no means a novel practice of government. In its days of secular authority, the church spoke firmly on the need for just pricing. In later times governments often blamed profiteers for increases in food prices. In the postwar period it has become customary for governments to stress the importance of stability in the general level of prices rather than the rectitude of individual prices. As of old, however, the authorities seek to limit private power in the marketplace by moral suasion. In today's world, as everyone knows, some trade unions can raise wages beyond the level that would prevail in a competitive labor market, just as some corporations have the power to push prices above competitive levels.

It is understandable enough, therefore, why our successive Presidents in the postwar period have seen fit to lecture the private community on the need for noninflationary conduct. General Eisenhower, for example, warned during his Presidency that "businesses must recognize the broad public interest in the prices set on their products and services" and that "greater stability of the general level of prices" is "unlikely unless the national average of increases in wage and salary rates and related labor benefits remains within the limits of national productivity gains."

In the last few years governmental pronouncements of this sort have become more frequent and louder. In fact, the urging of moderation on private parties has reached a scale that marks something of a break from the earlier policy of dealing with inflation. Thus:

On the one hand, the classical weapons of monetary and fiscal restraint, which in the past were relied on as the main defense against inflation, are now frowned on.

On the other hand, general appeals to public responsibility are being implemented by wage and price guideposts. Trade unions and business firms, in other words, are no longer merely asked or admonished to moderate their private power in the public interest; they are advised with a show of specificity how this can best be done.

Once exhortation has been fortified by formula, it can no longer be dismissed as sheer rhetoric. It then takes on new authority over the minds of men, and its capacity for good or ill becomes much greater.

Intended nature

The guideposts have been a major part of the administration's economic policy since early 1962, when they were first set forth by the Council of Economic Advisers. What are these guideposts or guidelines?

1. *Wages.*—This guidline specifies that the annual rate of increase in wage rates, including fringe benefits, should be equal in a particular firm or industry to the annual trend increase in national productivity; that is, to the average annual percentage rate of growth over a term of years in the output per man-hour of the economy at large.

2. *Prices.*—This guideline specifies that when the trend of an industry's productivity rises less than the national trend of productivity, its prices "can appropriately rise enough" to accommodate the rise in labor costs per unit of output that is indicated by the wage guideline; and that when an industry's productivity rises more rapidly than the national average, its prices "should be lowered" in keeping with the decline in unit labor costs.

The Council originally characterized its pronouncement on the guidelines as a contribution to public discussion of how the national interest may be judged in the case of private wage and price decisions. The guidelines were certainly not intended to be interpreted as directives to industry or labor. In fact, they were described by the Council as "general guideposts" which still had to be reconciled in individual situations with "objectives of equity and efficiency." In other words, "specific modifications" were required to adapt the guidelines "to the circumstances of particular industries."

The more important types of modification that would be likely to arise in practice were actually listed by the Council. For example, the suggestion was advanced that wage increases should exceed the "general guide rate" if the bargaining position of workers in a particular industry or locality had previously been weak or if an industry was unable to attract sufficient labor.

Actual effect

As was bound to happen, however, it was the crisp formula of the "general guideposts," not the qualifications or disclaimers, that mainly caught the public eye. And, with the passage of time, the administration has itself become bolder. Thus:

The January 1964 Report of the Council no longer speaks of the guidelines as a contribution to public discussion of how the national interest may be judged; instead, it describes them as a "standard" for private wage and price decisions.

The report of 1962 had avoided specifying the annual trend increase of national productivity on the ground that this was "a large and complex subject and there is much still to be learned." The report of 1964, on the other hand, is free from all methodological doubts and presents without qualification a figure of 3.2 percent as the annual trend increase of productivity in the private economy that is currently applicable.

The report of 1962 had indicated that the "general guideposts" were "only first approximations" that would need to be adapted extensively "to the circumstances of particular industries." The report of 1964, on the other hand, states flatly that the guideposts "can cover the vast majority of wage and price decisions" and, while the modifications that had been suggested earlier "still apply, * * * it must be emphasized that they are intended to apply to only a relatively few cases."

Thus, the official position, as now developed or clarified, is that the national interest can be best served by setting wages and prices in accordance with the formula of the general guidelines—not, to be sure, in every instance, but almost that.

TROUBLESOME CONSEQUENCES

As every economist knows, there are only two ways of raising the real earnings of labor. They can be raised by (1) increasing output per man-hour of work or (2) enlarging the share of total income that accrues to wage and salary workers.

Of these two sources, the first is basic, and it has always been vastly more important in our country than the second. The guidelines have the great merit of calling attention to this fact. Taking the economy as a whole, it is the cost

of labor that dominates production costs. If the cost of labor per unit of output rises, business firms will ordinarily seek to protect their profit margins by raising prices. But a rise in wage rates, using this term broadly so as to include fringe benefits, need not involve a rise in production costs. It will do that only if the rise in the hourly wage rate is proportionately greater than the increase in output per man-hour. Therefore, if the average percentage increase in wage rates across the Nation merely equals the average percentage increase in output per man-hour, the general level of prices could remain stable without reducing the fraction of the Nation's output accruing to stockholders and other income claimants.

By expressing this basic truth, the guideposts have helped to direct the attention of thoughtful citizens to ways of raising output per man-hour—ways such as investing in more and better tools of production, improving the education and skills of workers, improving the quality of management, and eliminating featherbedding and restrictive trading practices.

Public enlightenment, however, has been an incidental aspect of the guideposts. Being a tool of policy, they point to a course of action. Their essential purpose is to curb inflation—or, more precisely, to permit monetary and fiscal policies to stimulate production and employment without stirring up inflationary pressures from trade unions or corporations. And if the guidelines for prices and wages were generally observed, it is indeed true that the existing links between the flow of money to markets, on the one hand, and the flow of goods and services to purchasers, on the other, would be broken. In such a world the levels of wages and prices would be governed by formula, and they would no longer reflect the changing forces of market demand and market supply—as they now do. If the policy of the guideposts became fully effective, it would, therefore, change drastically the workings of our commodity and labor markets, and thereby modify—for better or worse—the character of our economic system.

Practical effects

Let us try to visualize a little more definitely how the guideposts, if they were generally and fully respected, would work out in practice.

Statistical records stretching back into the 19th century demonstrate that, although the overall productivity of our economy occasionally declines, its trend has been steadily upward. If this continues to be true, as we may reasonably suppose, general observance of the guidelines will result in higher wages every year, regardless of the stage of the business cycle or the level of unemployment or the state of the balance of payments. The rise of wages will be the same, on the average, in years of recession as in years of prosperity; but in any given recession the rise of wages could easily be larger than in the preceding years of prosperity. Furthermore, the average wage will tend to rise in any given year by the same percentage in every firm, regardless of its profitability or the state of the market for different kinds of labor.

However, general observance of the guidepost for prices will not freeze individual prices or the relations among them. What it would tend to freeze is (1) the general level of prices and (2) the ratio of individual prices to unit labor costs of production. The tendency of the price-cost ratio to remain constant will be stronger in some industries than in others. Strictly speaking, the guidepost for prices specifies merely that the ratio of price to unit labor cost of production should not rise; it does not argue against a decline of the price-cost ratio. Hence, firms or industries experiencing a weak demand for their products or keen foreign competition may need to be content with prices that decline relative to their unit labor costs. On the other hand, firms or industries that are favored in the marketplace would be unable to raise prices relative to their unit labor costs even if their incoming orders were many times as large as their production. Nor would they be able to raise prices to compensate for increases in costs of production other than those of labor.

The broad effect of these tendencies would be to keep more or less constant the percentage share of the national income—or of national output—going to labor. Changes in the use of capital relative to the use of labor, whether upward or downward, could still have a large influence on the size of the national income but not on the proportion of income accruing to labor. Unless major shifts occurred in the occupational or industrial distribution of employment, any fluctuation in labor's percentage share of the national income would be due primarily to the discrepancy between the movement of overall productivity in a particular year and the corresponding trend increase. Nonlabor income, in

the aggregate, would also tend to be a constant percentage of the national income.

It is well to bear in mind, however, that since profits are only a fraction of nonlabor income, the share of profits in the total national income could either rise or decline. In the postwar period, the amount paid by corporations on account of excises, customs duties, property taxes, licensing fees, and other indirect taxes has risen more rapidly than their net output. If this trend continues, the income share of investors in the corporate sector will tend to undergo a persistent decline, while that of labor will tend to remain constant.

Throttling of competition

In the hypothetical economy that I have sketched, monopolies—whether of business or labor—would no longer have the power to push up the price level. Put more precisely, if trade unions and business firms complied voluntarily with the guidelines, they would relinquish any market power that they have not yet used or that they might gain in the future. This is worth noting, but it is not the main point.

The fundamental point of the preceding analysis is that general observance of the guideposts would throttle the forces of competition no less effectively than those of monopoly. The point is important because, unlike much of the rest of the world, the rivalry among U.S. business firms is very keen. Even in industries where a few corporations dominate the market—as in the case of automobiles, steel, and aluminum—each corporation competes actively against the others in its industry, against rival products of other industries, and against foreign suppliers. Competition in labor markets is also stronger than casual references to labor monopoly may suggest. After all, only a little over a fourth of the population working for wages or salaries is unionized, and many of the trade unions are weak. By and large, it is competition—not monopoly—that has vast sweep and power in our everyday life. Since free competitive markets would virtually cease to exist in any economy that observed the guidelines, this transformation of the economy merits serious reflection.

To be sure, compliance with the guidelines would be voluntary in the economy we are considering. That, however, may not mean much. For when economic freedom is not exercised, it is no longer a part of life. As far as I can see, an economy in which wages and prices are set voluntarily according to a formula suggested by the government would be almost indistinguishable from an economy in which wages and prices are directly fixed by governmental authorities. In either case—

> * * * the movement of resources toward uses that are favored by the buying public would be impeded;
>
> * * * the tendency to economize on the use of what happens to be especially scarce, whether it be materials or labor or equipment, would be weakened;
>
> * * * since prices will no longer tend to equate demand and supply in individual markets, some form of rationing would need to be practiced.

In all likelihood, therefore, a shift from our present market economy to one of voluntary compliance with the guidelines would adversely affect efficiency. It would also adversely affect the rate of economic growth and the rate of improvement of the general standard of living.

It is true, of course, that controlled economies can and do escape complete rigidity. The exigencies of life do not permit their authorities to be blind to considerations of efficiency or social harmony, so that price and wage edicts have to be modified here and there. Black markets tend to develop, and—despite their unsavory character—they often perform a useful function in facilitating production. Moreover, managers gradually become skillful in "gray practices," such as reclassifying labor in order to escape the wage restraints or modifying products in order to escape the price restraints. Our hypothetical economy of voluntary compliance would also have its safety valve; that is to say, the guidelines would be modified in "a relatively few cases" in the interest of equity or efficiency. However, gray or black markets, which impart some fluidity and resilience to authoritarian economies, could not exist in the economy of voluntary compliance that we have been considering here.

ARE THE GUIDES WORKABLE?

This theoretical sketch of how our economy would work if the guidelines were generally and fully observed has blinked institutional factors—such as the adjustments caused by the disappearance of auction markets, the new role of trade

unions, and so on. Moreover, our theoretical sketch has tacitly assumed that voluntary compliance with the guidelines is merely a matter of will. Life is not that simple. Even if everyone responded to the Government's plea for "cooperation" and sought faithfully to act in accordance with the guidelines, it would frequently be difficult or actually impossible to do so.

There is, first of all, a vast gap in our statistical arsenal. To comply with the guideline for wages, businessmen would need to know the trend increase of the overall output of the Nation per man-hour. Once this highly complex magnitude had been estimated by the Government, it would presumably be subjected to outside review, revised if need be, and accompanied by a specification of the boundaries of the year (if a year be the interval) to which it would apply. All firms dealing with labor, except those newly established, would then know what wage adjustment was expected of them.

Compliance with the price guideline would be infinitely harder. For this purpose, every company would need to know the trend increase in the productivity of its own industry and how this increase compares with the trend increase of overall productivity of the economy. Such information is not generally available, nor is it readily usable.

Applying the indexes

The productivity indexes now being published, besides being often out of date, lump together a great variety of products. In time, more detailed and more current indexes of productivity will doubtless be constructed, but there are limits to what is statistically feasible. Even if measures of this type become available for each of a thousand or ten thousand industries, much confusion or perplexity will still remain:

Should a manufacturer of bricks, for example, be guided in his pricing by an index of productivity for the stone, clay, and glass group or by an index confined to brick manufacture?

If the latter, is the pertinent index a nationwide measure, one confined to his region, or perhaps to his locality or plant?

How should a manufacturing firm proceed when its output is not standardized or when it makes a hundred different items, instead of just one product?

If the appropriate index is not available, as may long remain the case for many firms, especially in the service trades, what is the best "proxy" for it?

Will the judgment of a company's management on such issues, even if made entirely in good faith, be acceptable to others—such as its trade union, the Council of Economic Advisers, or the general public—who also seek only what is right?

Better statistics on productivity will reduce these difficulties; however, they cannot possibly remove them.

Changes in work force

Another puzzling problem would be posed by changes in the composition of labor that is used in industry. Consider, for example, the case of a company that has recently decided to employ more skilled workers of different sorts and less unskilled labor:

Since skilled labor is compensated at a higher rate, the average wage per hour that is paid by the company to its workers will go up, quite apart from any wage increase that may be needed for the individual grades of labor. Let us now suppose that the wage guidepost calls for an increase of, say, 3 percent. Then the company's employees will naturally expect an increase of this size in their individual rates of pay.

But may not the company's personnel executive, who has become steeped in the mathematics of the guidelines, properly insist that the average wage has already gone up this much or more on account of the more intensive use of skilled labor and that no increase of wage rates is therefore warranted by the Government's guideline? Will the trade union's representative grasp this statistical subtlety? Will he not argue that the guideline requires an increase of 3 percent, that other organizations are putting through such increases, and that simple justice requires that the same be done by this company?

Suppose that the personnel executive perseveres and finally convinces the union's representative. Will the latter, in turn, be able to persuade the company's employees? Can we even be sure that the company's board of directors will be convinced by the argument of its personnel officer?

In view of modern trends that emphasize the use of higher skills, this sort of

difficulty would be bound to occur frequently in an economy of voluntary compliance.

Other pitfalls and puzzles

A related puzzle with which businessmen would need to grapple arises from changes in the composition of output. Suppose that a firm has two plants, that each of them makes a unique product, that the output per man-hour is constant in each plant, but that the two plants differ in efficiency. If the wage guidepost calls for a 3 percent increase in wages, it might appear, since no improvement of productivity has occurred in either plant, that a corresponding increase in the price of each of the two products is justified by the guideline for prices. But are price advances really proper if the firm has shifted some workers from the less efficient to the more efficient of its two plants and thereby raised the output per man-hour of the entire firm as much as or more than the trend increase of national productivity? In that event, does the guidepost for prices require that the productivity of each plant be taken separately or that the two be taken in combination?

Another problem that businessmen and trade-union leaders would need to face is whether the modifications of the guideposts that the Council of Economic Advisers has officially sanctioned apply in a particular case. In assuming, as I have, a general willingness to comply with the guidelines, I have not meant to abstract from human nature entirely. Since the modifications suggested by the Council are phrased in very general terms, men acting in good faith may feel that their situation is precisely the kind of rare case that permits some departure from the guidelines. But will business managers and labor leaders always or even frequently agree in their interpretation of what modifications are permissible? In any event, is it not likely that the modifications will turn out to be numerous, rather than, as now intended by the administration, relatively few?

In view of these and many other problems that are bound to arise in practice, the guidelines would prove unworkable over a very large segment of industry, even if everyone sought conscientiously to observe them. To deal with this critical difficulty, a new governmental apparatus might need to be established; its function would be to spell out detailed rules and to interpret them in individual cases. Although there is no way of telling just how such an agency would work, it seems reasonable to expect that not a few of its clarifying rules and interpretations would be arbitrary, that its advisory rulings would at times involve considerable delay and thereby cause some economic trouble, and that the rulings themselves would have at least some inflationary bias. These factors inevitably cast a cloud over the preceding analysis of how an economy of voluntary compliance would function, but they hardly make the prospect more inviting.

SPECTER OF CONTROLS

I have as yet said nothing about the aspect of guidepost policy that has aroused the most skepticism—namely, the likelihood of general observance on a voluntary basis. In recent years unemployment has been fairly large, and many industries have had sufficient capacity to increase output readily. Under such conditions, upward pressure on prices cannot be great. Even so, the guidelines have been sharply criticized or defied by powerful segments of the business and labor community. The critical test of the inhibiting power of the guidelines will come, of course, when both labor and commodity markets become appreciably tighter—and this test may come soon. If the recent wage settlement in the automobile industry is at all indicative, expectations of a high degree of compliance with the guidelines are hardly warranted. Similar experiments in other countries also suggest that general price stability will not long be maintained through voluntary restraint.

But once the government in power has committed itself to a policy, it may become difficult to move off in a new direction. A strong commitment to the policy of the guidelines inevitably means that any extensive private defiiance would, besides frustrating the Government's anti-inflation policy, injure its prestige. There is always a possibility, therefore, that failure to comply voluntarily with the guidelines will be followed by some coercive measure. This might initially take the form, as has frequently been proposed, of a review by a governmental board of the facts surrounding the price or wage changes that are being contemplated. The thought behind proposals of this nature is that once the facts are clearly developed, the force of public opinion will ordinarily suffice to insure "responsible" action by corporations and trade unions.

No one can be sure whether this expectation will be fulfilled. But if it is, the governmental review board will have virtually become an agency for fixing prices and wages. If, on the other hand, the board's reports were flouted with any frequency, the next step might well be outright price and wage fixing by the Government. It would seem, therefore, that from whatever angle we examine the guidelines, direct controls pop up dangerously around the corner.

Incipient realities

This danger must not be dismissed as an illusion. Although the guidelines are still in their infancy, they have already hardened, as I previously indicated. Nor has the evolution of the administration's thinking concerning the guidelines been confined to a literary plane. In April 1962, only 3 months after the announcement of the guidelines, the administration moved sternly to force the leading steel companies to cancel the price increases that they had just posted. This interference with the workings of a private market had no clear sanction in law, and it caused consternation in business circles. Fortunately, a crisis was avoided by a prompt and concerted effort of the administration, in which President Kennedy himself took the leading part, to restore business confidence.

Since then, the Government has been more cautious. But it has continued to espouse the need for moderation in the matter of wages and prices, and now and then has even gently rattled its sword. Early in 1964 President Johnson requested the Council to reaffirm the guideposts. He emphasized his commitment to this policy by adding that he would "keep a close watch on price and wage developments, with the aid of an early warning system which is being set up." Last summer, when intimations of a rise in the price of steel appeared in the press, the President lost no time in declaring that such action would "strongly conflict with our national interest in price stability."

TOWARD SOUNDER POLICIES

As this account of recent history suggests, the guidepost policy may, under the pressure of events, move our Nation's economy in an authoritarian direction. The danger may not yet be large, in view of prevailing political attitudes, but it could become serious in a time of trouble or emergency. And this is not the only risk, as I shall presently note. However, the fact that many citizens both within and outside Government favor the guidelines must also be considered, for it means that they see smaller risks or larger advantages in this policy than I do.

It may readily be granted that the guidepost policy has the meritorious objective of blunting the power of monopolists to push up the price level. This is the feature of the policy that its proponents often stress. Indeed, they are apt to argue that it matters little in practice whether or not the bulk of the economic community pays any attention to the guidelines—as long as the major corporations and trade unions do so.

But if the guidelines are circumscribed in this fashion, they are still subject to the criticism of interfering with the competitive forces of the markets in which many major corporations actually operate. Moreover, the absence of a precise indication of what firms, industries, or trade unions are covered by the guidelines can create a mood of uncertainty that will militate against compliance. Not least important, the effectiveness of the guidelines in curbing inflation becomes doubtful when their application is restricted. For the very limitation on wage and price increases in the guideline sector of the economy would facilitate increases in the uncovered sector whenever an expansive economic policy generated a monetary demand that grew faster than the supply of goods and services.

Another argument frequently advanced in favor of the guideposts is that if they were in fact respected on a sufficient scale, then profit margins would tend to be maintained and the chances of prolonging the current business expansion would therefore be improved. This consideration is bound to count in men's thinking at a time when our Nation is striving to reduce unemployment and to spread prosperity.

We must not, however, become so absorbed in today's problems that we overlook those that will haunt us in a later day. If the guidelines may stretch out the expansion now by helping to maintain the relatively high profit margins of prosperity, may they not at some later time stretch out contraction by serving to maintain the low-profit margins of recession?

Let me add, also, that I recognize that the guideline policy was adopted by the administration only after it had given serious consideration to alternatives. The thought of its economists apparently is that, in general:

Monetary and fiscal tools must be used to promote expansion as long as the economy is not operating at full employment.

Other devices must therefore be employed (in the absence of full employment) to prevent inflation.

Policies aiming to increase competition or to improve productivity cannot accomplish much in the short run or cannot be pushed hard for political reasons.

Direct controls of wages and prices cannot and should not be seriously considered under peacetime conditions.

Consequently, there is only one major way left for curbing immediate inflation—namely, through devices of exhortation.

And the guidelines for wages and prices are merely a promising specific application of the technique of exhortation.

Locus of responsibility

Space will not permit me to unravel this complicated argument, but I at least want to suggest why I think it may be faulty. Once the Government looks to trade unions and business firms to stave off inflation, there is a danger that it will not discharge adequately its own traditional responsibility of controlling the money supply and of maintaining an environment of competition. In the past our own and other governments have often found it convenient to blame profiteers, corporations, or trade unions for a rising price level. Only rarely have they pointed the finger of blame at their own policies—such as flooding the economy with newly created currency or bank deposits.

To the extent that the Government relies on private compliance with its guidelines for prices and wages, it may more easily be tempted to push an expansive monetary and fiscal policy beyond prudent limits. Besides, it may fail to resist strongly enough the political pressure for higher minimum wages, larger trade union immunities, higher farm price supports, higher import duties, more import quotas, larger stockpiling programs, and other protective measures that serve either to raise prices or to prevent them from falling.

One of the major needs of our times is to give less heed to special interest groups and to reassert the paramount interest of consumers in vigorous competition. The political obstacles to reducing artificial props for prices are undoubtedly formidable. However, reforms of this type—supplemented by more stringent antitrust laws, effective enforcement of these laws, and reasonable steps to curb featherbedding—are likely to contribute more to the maintenance of reasonable stability in the general price level than will the guidelines for wages and prices on which we have recently come to rely.

Guidelines for Government

Another major need of our times is for better guidelines to aid the Government itself in formulating and carrying out its economic policies. The widespread tendency of attributing most existing unemployment to a deficiency of aggregate demand is an oversimplification. Thus:

When the amount of unemployment is larger than the number of job vacancies at existing wages, the aggregate demand for labor is clearly insufficient to provide employment for everyone who is able, willing, and seeking to work. At such a time, a deficiency of aggregate demand exists, and a governmental policy that relies on monetary and fiscal devices to expand demand is, in principle, well suited to the Nation's needs.

When the number of vacant jobs is equal to or larger than the number of the unemployed, however, there is no deficiency of aggregate demand. A government that is seriously concerned about inflation will not pursue an expansive monetary and fiscal policy at such a time, and—instead of lecturing the private community on the need for moderation—will itself lead the nation in a policy of restraint. This does not mean its concern about unemployment will cease but, rather, that it will direct its policy measures toward better matching of the men and women who seek work with the jobs that need to be filled.

A sensible guideline for monetary and fiscal policy is, therefore, not the volume or rate of unemployment as such, but the relation between the number of the unemployed and the number of job vacancies. As yet, such a guideline is merely a theorist's dream because statistics on job vacancies hardly exist in our country. There are grounds for hoping, however, that this condition will be corrected in another few years, so that we will become better equipped for promoting our national goals.

The problem of achieving and maintaining prosperity without inflation in a free society is a very difficult one. We must be willing as a people to seek out and to explore new ways of meeting this critical challenge of our times. But we also must remain mindful of the lessons of past experience—particularly, the need for prudent control of the money supply and the need for maintaining and enhancing the forces of competition. The progress that we make will depend heavily on the economic understanding of citizens and the intensity of their interest in public policies.

AUTHOR'S NOTE.—These views were originally presented as a John F. Murray lecture sponsored by the College of Business Administration, the University of Iowa, Iowa City, Iowa.

III

(Added exhibit inserted in the record at the request of Senator Javits.)

Statement by Roman L. Hruska, U.S. Senator From the State of Nebraska

In the 1965 Annual Report of the Council of Economic Advisers, there is contained for the first time a discussion relating to the extent of concentration of American industry, under the section heading, "Trends in Industrial Structure" (pp. 132–135). The text in this section apparently intends to give the impression that American industry is becoming more and more concentrated, with control over an ever larger proportion of the economy falling into a few hands.

In my judgment, this is a distorted picture of the true situation. The material contained in this section of the report consists largely of extracts from the data developed in connection with hearings held last year on the topic, "Economic Concentration," by the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, and on certain studies previously published by the same subcommittee. However, the presentation in the report of the Council of Economic Advisers is a less than full and unbiased summary of all the known facts on this problem; it represents a one-sided selection from among the material available which will mislead, not enlighten, the public.

Three specific objections to the discussion contained in the Council's report will be mentioned here.

First of all, the report omits entirely any mention of those sectors of the Nation's economy where competition has visibly increased, as, for example, between the different modes of transportation. This section of the report discusses only the manufacturing sector of the economy, although certainly any fair discussion of "trends in industrial structure" would necessarily require at least a mention of other sectors.

Second, the report makes much of a claimed increase between 1947 and 1962 in the share of the total U.S. market for manufactured goods supplied by the 100 largest U.S. manufacturing firms.

The question arises: Why is 1947 selected as the starting point for such a comparison? Evidence presented to the Antitrust and Monopoly Subcommittee, extending as far back as 1901, strongly indicated that, if anything, the trend in concentration of industry over the long run had been downward.

Even if we concede that the early data are not entirely reliable, this cannot be said of the careful estimates of overall concentration given us which were based upon tabulations of income tax returns by the Internal Revenue Service, for the period 1931–60. These estimates showed virtually no change in the percentage of overall concentration between 1931 and 1960. The data indicate a downward dip in this percentage during the 1940's; the previous decline was canceled out by a subsequent increase, so that the overall concentration level for 1960 was almost exactly the same as that for 1931.

In other words, an argument that concentration has increased can be made only if the comparison starts with 1947, as it does in the Council's report; 1947 is the low year. If 1947 is picked as the starting point, the statistics may appear to show an increase in concentration, but such a synthetic increase depends upon artful selection of the years to be compared. The sounder method is to use the longest span of years available as the basis from which to derive longrun trends; when that is done by comparing 1931 with 1960, it is hard to find a distinct trend of any kind. The year 1931 is the logical and sound starting point. It is the year in which the Internal Revenue Service began publishing corporate balance sheets by asset-size classes.

Dr. M. A. Adelman, of the Massachusetts Institute of Technology, past consultant to the Census Bureau on the subject of concentration and probably

our present leading authority on it, developed the estimates in question, which are summarized in the following tabulation:

Assets for the equivalent of the 117 largest manufacturing firms, as a percentage of the assets of all manufacturing firms.

Year	*Percentage*	*Year*	*Percentage*
1931	44.7	1945	41.9
1932	46.2	1946	38.8
1933	45.6	1957	45.4
1942	42.0	1958	44.8
1943	42.8	1959	44.5
1944	42.6	1960	44.6

Dr. Adelman's own conclusions are worth quoting:

"* * * As you can see, there was an increase from 1931–32, and then a decrease. There was an increase from 1942–43, and then a decrease through 1946. There was a decrease from 1957 through 1959 and then a slight increase to 1960.

"How are we to interpret these observations? There is room for at least three hypotheses: First, as suggested by Willard F. Mueller, a cyclical movement. But this implies a regular recurrent motion, for which, in my opinion, there is too little evidence. The second hypothesis is an irregular fluctuation. The third would be no real change in the underlying data, but the disturbances of depression, war, and reconstruction generated some meaningless change in the observations. My own feeling is that the truth lies somewhere between the second and third hypotheses, but there is no way of rigorously disproving the others. Perhaps later research will tell us more, though it would take a large-scale effort at best.

"One result can under no circumstances be gotten out of these data, and that is the notion of any long-term increase in 'overall concentration.' If there was a cyclical movement, with a decline from about 1935 to about 1947, as Mueller thinks, then we ought to measure from peak to peak, 46.2 percent in 1932, and 45.4 percent in 1957. Or if we simply use terminal years, that would be from 44.7 percent in 1931 to 44.6 percent in 1960. If we preferred to use groups of 3 years, in order to avoid single-year fluctuations, we still have a mild decrease from 1931–33 to 1958–60.

"I know that it is the official truth, particularly in the Supreme Court today, that concentration was increasing before World War II, during World War II, and after World War II, right down at least to the passage of the amended Clayton Act in 1950. They can now either take it from Mueller, who thinks concentration was actually decreasing from about 1935 to about 1950, or from me, who would say merely that it was at least not increasing. Either way, it is worth reflecting on a law professor's opinion that while Congress may have been all wrong in thinking in 1950 that concentration was increasing, still we cannot set this opinion aside merely because some statisticians have shown it to be false."

So much for the central theme contained in this section of the Economic Council's report, dealing with the alleged increase in overall concentration.

Finally, objection must be made to the discussion in the Council's report on "industry concentration," and particularly to table 18, entitled, "Concentration in selected industries, 1947 and 1958." This table presents concentration ratios (percentages of value of shipments accounted for by the four largest firms in the industry) for 1947 and 1958 for 14 selected industries. No explanation is given in the report as to the basis on which these particular industries were selected from among the more than 400 industries classified under the Government's standard industrial classification.

Of the industries thus selected for individual display, eight showed an increase in concentration between 1947 and 1958, five showed a decrease, while data were lacking for the 14th. In other words, the table gives the implication that on an industry basis, concentration is increasing in more cases than not.

In fact, the contrary is true. There is ample testimony to that effect by distinguished authorities in the hearings before the Antitrust and Monopoly Subcommittee. The generally downward trend in industry concentration is well summarized by a table presented by Dr. Lee E. Preston, of the University of California at Berkeley, which is attached to this statement. Dr. Preston's table shows that, of the industries for which a comparison between 1947 and 1958 was feasible, more showed decreases in concentration than the number

showing increases (see table 1 attached hereto). This trend was particularly marked among the larger industries.

The downward trend in industry concentration was also particularly marked in industries which had previously been somewhat concentrated. Table 2 attached makes appropriate comparisons for 44 major industries classified as highly concentrated in 1947 according to objective tests. Of these 44 industries, it can be seen that 29 showed a decrease in the 4-producer concentration ratio between 1947 and 1958, while only 15 showed an increase and 5 showed no change.

It is hoped that this statement will be useful in evaluating the section in the Economic Council's report entitled, "Trends in Industrial Structure."

TABLE 1.—*Change in 4-firm concentration ratio, 1947–58, by size of industry in 1958*

Change in concentration level (percentage points)	Size of industry (value of shipments)									
	$1 billion and over		$500 to $999 million		$100 to $499 million		Under $100 million		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
+10 or more	3	6	3	5	16	11	15	14	37	10
+3 to +9	9	19	6	11	38	25	29	27	82	22
−2 to +2	18	38	20	36	39	26	27	25	104	29
−3 to −9	9	19	19	34	40	27	23	21	91	25
−10 or more	8	17	8	14	17	11	14	13	47	13
Total	47	100	56	100	150	100	108	100	361	100

Source: "Concentration Ratios 1958," table 2-A. Reprinted from "Economic Concentration, Part 1," p. 68.

TABLE 2.—*Major industries*[1] *with the 4 largest companies accounting for more than 50 percent and the 8 largest for 75 percent, or more of the value of shipments, 1947*

Industry code	Industry	1947 percent of value of shipments accounted for by—		1958 percent of value of shipments accounted for by—		4 largest companies change 1947–58 percent points
		4 largest companies	8 largest companies	4 largest companies	8 largest companies	
2026	Special dairy products	62	75	51	62	−11
2043	Cereal breakfast foods	79	91	83	95	+4
2052	Biscuit and crackers	72	78	65	72	−7
2072	Chocolate and cocoa products	68	81	71	84	+3
2073	Chewing gum	70	87	88	95	+18
2092	Shortening and cooking oil	59	81	49	75	−10
2093	Margarine	64	90	62	86	−2
2094	Corn wet milling	77	95	73	92	−4
2111	Cigarettes	90	+99	79	+99	−11
2131	Chewing and smoking tobacco	61	81	57	82	−4
2141	Tobacco stemming and redrying	88	95	73	90	−15
2223	Thread mills	65	87	68	79	+3
2274	Hard-surface floor coverings	80	95	83	(D)	+3
2812	Alkalies and chlorine	70	93	64	89	−6
2824	Synthetic rubber	[2] 80	100	60	86	−20
2825	Synthetic fibers	78	94	78	96	0
2826	Explosives	80	89	77	89	−3
2841	Soap and glycerin	79	86	90	94	+11
2862	Softwood distillation	86	94	89	96	+3
2895	Carbon black	78	97	73	98	−5
2896	Compressed and liquefied gases	83	88	79	88	−4
3011	Tires and inner tubes	77	90	74	88	−3
3021	Rubber footwear	81	93	65	82	−16
3221	Glass containers	63	79	58	75	−5
3261	Vitreous plumbing fixtures	58	82	54	75	−4
3272	Gypsum products	85	94	88	96	+3
3297	Nonclay refractories	62	75	62	74	0
3313	Electrometallurgical products	88	(3)	73	91	−15
3334	Primary aluminum	100	100	[4] 96	100	−4
3351	Copper rolling and drawing	60	77	48	68	−12
3352	Aluminum rolling and drawing	94	99	78	85	−19
3411	Tin cans and other tinware	78	86	80	89	+2
3511	Steam engines and turbines	88	97	87	97	−1
3521	Tractors	67	88	69	90	+2
3571	Computing and related machines	69	83	77	85	+8
3572	Typewriters	79	96	79	99	0
3584	Vacuum cleaners	61	87	70	89	+9
3593	Ball and roller bearings	62	79	57	77	−5
3612	Carbon and graphite products	87	93	87	92	0
3615	Transformers	73	84	71	84	−2
3641	Engine electrical equipment	67	81	63	79	−4
3651	Electric lamps (bulbs)	92	96	92	97	0
3662	Electronic tubes	73	92	53	69	−20
3663	Phonograph records	79	87	76	83	−3
3691	Storage batteries	62	78	64	81	+2
3692	Primary batteries	76	95	84	95	+8
3722	Aircraft engines	72	88	56	77	−16
3723	Aircraft propellers	98	+99	97	99	−1
3741	Locomotives and parts	91	95	95	99	+4

[1] Industries with a value of shipments in 1958 of more than $100,000,000.
[2] Percentage withheld byBureau of Census, but since there were only 5 companies in this industry in 1947, the 4 largest logically must have accounted for at least 80 percent of shipments.
[3] Percentage withheld to avoid disclosing figure for individual companies.
[4] Same figure as was used by Blair, based upon his calculation from data in Standard & Poor's "Industry Surveys."

Source: "Concentration Ratios in Manufacturing Industry, 1958," table 2. Reprinted from "Economic Concentration, Part 1", p. 447.

IV

(The following exhibit was included at the request of Senator Douglas:)

British Balance-of-Payments Crises in the Postwar Period[1]

Gerald A. Pollack

I

1947

Under the 1946 Loan Agreement with the United States (for $3,750 million) Britain reluctantly agreed to restore convertibility of sterling no later than July 15, 1947.

A balance-of-payments crisis began to develop at the end of 1946, when convertibility was gradually introduced. From a deficit of around $50 million a month in the first three quarters of 1946, the monthly rate increased to $135 million in the final quarter, more than $200 million in February 1947, over $500 million in July 1947, and more than $600 million in August.

When these drains forced Britain to end convertibility on August 20, 1947, she had lost $3.6 billion of the $5 billion credits granted by the United States and Canada.

The basic reason for the crisis was that many nations had accumulated sterling balances during the war, but, in the early postwar years, they wanted dollars, not pounds, to buy the goods they needed. England was the only one of Europe's belligerents to restore convertibility, and such agreements as it had concluded with sterling holders to prevent immediate conversion of their balances proved inadequate. The pound became the bridge to the dollar, and convertibility was crushed in the stampede to buy dollars.

After convertibility was suspended in August 1947, Britain adopted import restrictions which cut back sharply on purchases in the United States. Other sterling countries also agreed to curtail their dollar imports.

II

1949

The British payments crisis of 1949 had two basic causes:

(1) The first postwar recession in the United States resulted in a decline of U.S. purchases from the sterling area at a time when that area's expenditures in the United States were increasing; and

(2) Widespread expectations that the pound would be devalued resulted in strong speculative selling of sterling.

The British balance of payments deteriorated early in 1949, after improving for 18 months. In the second quarter of 1949 the deficit doubled, and British gold reserves declined by £160 million. Attempting to stop this drain, Britain restricted dollar imports, applied for more Marshall plan aid, and persuaded other sterling countries to cut back on their dollar purchases.

The effect of these measures, while considerable, was too slow. On September 18, 1949, Britain announced her 30-percent devaluation which triggered a major

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[1] Memorandum to members of the Joint Economic Committee from James W. Knowles, executive director, Dec. 8, 1964.

realinement of the international values of the important European currencies. In addition, measures were taken to cut investment and Government spending to assure that the pressures of home demand would not divert British output from export to domestic markets.

By early 1950, the British situation had improved greatly. At the end of 1949, 60 percent of the foreign exchange loss had been recouped, and the rest was regained by April 1950. While the devaluation undoubtedly played an important part in this improvement, even more important factors were economic recovery in the United States, which increased foreign demand for sterling commodities, and curtailment of sterling area dollar purchases.

III

1951–52

The world experienced a boom in the years 1950–51, partly as a result of the Korean war and partly because of rapidly increasing output in the United States, then recovering from the 1949 recession, and in Germany, making its first major advance of the postwar years. The boom was accompanied by sharply rising prices. In addition, the British economy experienced the strains of major increases in defense spending. Within a year, the British suffered a balance-of-payments crisis. From a surplus of some £300 million in 1950, the balance of payments shifted to a deficit of more than £400 million in 1951.

The deterioration was caused by these major influences:

(1) Increasing import prices.

(2) A £150 million fall in invisible earnings partly because Persia seized the Abadan oil refineries in March 1951.

(3) Imports rose abruptly because of speculative inventory accumulation, high production and demand, and increased food consumption.

(4) A major deterioration in the position of the rest of the sterling area, between the first and second 6 months of 1951, the dollar earnings of the oversea sterling area fell by nearly 50 percent.

The major policy measures adopted to cope with the balance-of-payments crisis were these:

(1) Drastic restrictions on imports, both by Britain and other sterling countries;

(2) A reduction in the tourist allowance to £25;

(3) An increase in the bank rate in November 1951 from 2 to 2½ percent and to 4 percent in March 1952;

(4) Imposition of restrictions on consumer credit; and

(5) Adoption of various measures to curtail fixed investment.

The balance of payments improved in 1952 when Britain experienced its first inventory recession since the war, which caused imports to fall, and when import prices declined substantially.

IV

1955

In 1955, Britain enjoyed a boom, paralleling rapid economic expansion in continental Europe and the United States. Consumption and investment were stimulated by the general prosperity and, in addition, by certain tax concessions. Imports rose rapidly, for the boom required steel and other metals, coal and oil, which could not be supplied domestically. These products were supplied from outside the sterling area, to the detriment of the balance of payments. Britain's payments difficulties were intensified by a largely fortuitous decline in earnings from invisibles, a deterioration in the position of the oversea sterling area, and some speculation against the pound.

To remedy the balance-of-payments deficit, the Government raised purchase taxes and the tax on distributed profits; took various steps to curtail public investment; raised the bank rate from 4½ to 5½ percent; suspended the investment allowance; cut public investment programs; tightened consumer credit; and adopted several other minor measures of a deflationary sort.

Britain's balance of payments recovered in the early part of 1956, and the improvement was maintained until the final quarter of the year when the Suez crisis again caused a deficit.

V

Suez—1956

The Suez crisis provoked a run on the pound, even though the underlying developments in Britain's balance of payments were favorable. In the final quarter of 1956, British reserves declined about $650 million. In December, Britain drew $561 million from the IMF and arranged for further credits of about $1,239 million with the IMF and the United States Eximbank, to be drawn as needed. In addition, Britain applied to the United States and to Canada for a waiver of interest due on postwar loans. Speculative pressures ceased after the announcement of Britain's arrangements with the Fund. With the exception of higher duties on petroleum products, no new measures were taken to curtail imports.

VI

1957

In late summer 1957, shortly after the Suez crisis subsided, sterling suffered another setback. The difficulty, this time, was a crisis of confidence. Speculators sold sterling, believing that exchange rates for a number of currencies would be realined and lacking confidence in the pound. At the time, the Government attributed the crisis to the fear of inflation. It increased the bank rate from 5 to 7 percent both to halt the drain on reserves and to restrain price increases. Measures were taken to stabilize public and private expenditures and to improve the short-term capital account. In retrospect, the fear of inflation appears to have been a relatively minor factor in the crisis. Britain also drew $250 million on an existing line of credit with the Export-Import Bank and renewed its standby arrangement with the IMF.

VII

1961

The British exchange crisis of 1961 followed a deterioration in the basic balance of payments after mid-1959 which had been, until early 1961, offset by substantial inflows of short-term funds. In large part, these inflows resulted from speculation against the dollar. Britain's underlying deficit was abruptly exposed when the movement of short-term funds was reversed as a result of abatement of pressure on the dollar in January 1961 and the German mark and Dutch guilder revaluations in March.

Beginning in February 1961, official reserves declined month by month, even though Britain received short-term support of $900 million from a number of central banks in Europe under the so-called Basle arrangements. Even with this assistance, United Kingdom reserves fell by almost $800 million in the first 7 months of 1961.

As the outflow of reserves continued to mount in June and July, the Government was impelled to take further action. On July 25, the authorities announced the following steps: An increase of 10 percent in excise and purchase taxes to restrain private consumption; tight credit to check inventory accumulation and

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certain capital outlays; a self-denying ordinance on the increase of expenditure in the public sector; a close review of Government expenditures abroad; an increase in the bank rate to 7 percent; the initiation of a wages policy; and the establishment of the National Economic Development Council for cooperative planning with labor and business to promote sound economic growth.

Moreover, in August, Britain arranged for an IMF drawing equivalent to $1,500 million and a standby credit for a further $500 million.

These measures quickly improved the balance of payments. By the end of 1961, the assistance received under the Basle arrangements had been repaid and the United Kingdom liability to the IMF had been reduced by $420 million. By April 1962, the basic balance of payments had shifted from a deficit to a small surplus, with imports and the net outflow of long-term capital both on a lower level. Moreover, short-term funds had moved to London in substantial volume and official reserves had risen. However, the price of these gains was some easing of economic activity and the creation of a margin of unused productive resources.

VIII

1963

Sterling came under pressure in the first quarter of 1963 for three reasons:

(1) The breakdown of Britain's Common Market negotiations;

(2) A shift by Spain and some Scandanavian countries out of sterling when, under the new European Monetary Agreement, Britain removed the gold guarantee from sterling balances held by other EMA countries;

(3) A debate in the financial press concerning the pros and cons of devaluation should the Government's expansionary program create a balance-of-payments crisis.

To cope with these pressures, Britain obtained $250 million in support from other European central banks in February and March. The balance of payments improved during the second quarter of 1963 and Britain was able to repay its borrowing while adding around $100 million to its gold and foreign exchange reserves.

The Government did not alter, as a consequence of the balance-of-payments difficulties of the first quarter, its expansionary policies designed to promote economic growth. Certain steps, however, were taken to attract foreign private capital. In mid-March, the Bank of England used a newly authorized technique to push up Treasury bill yields. In addition, the Bank of England announced on April 19 a new Treasury bond offering with features particularly attractive to foreign investors—the bonds were available in bearer form and were tax exempt for nonresidents.

IX

1964

Sterling weakened in February 1964 as a result of some speculative capital outflows. This weakness ended after February 27, when the Government increased the bank rate from 4 to 5 percent, a move which had been expected for some time in connection with efforts to moderate the pace of expansion.

A balance-of-payments problem of major dimensions faced the incoming Labour Government in October 1964. This time the problem had its roots in Britain's basic balance, not in speculative, short-term capital movements, although the crisis, in its late and dramatic stages, was essentially one of capital flight. Britain's trade balance deteriorated substantially after mid-1963. The severity of this deterioration became evident only in late summer. Long-term capital outflows increased, adding to the pressures on the pound. But no crisis developed until late in the year.

The Economist for November 28, 1964, observed: "Sterling did not begin to come under any real pressure until barely 3 months ago. Before then Britain's

large underlying deficit on current and long-term capital account was financed surprisingly smoothly, largely by the buildup of the London balances of the over-sea sterling area. The central reserves themselves actually rose from January through June and the subsequent dips in July and August, always seasonally poor months, were in the circumstances relatively modest. No significant re-course had to be made to central bank credits throughout the first 8 months of the year."

When the Labour government assumed office in October, it had to contend with a balance-of-payments deficit on the order of magnitude of $2 billion for 1964. The situation had been allowed to drift by a Conservative Government hoping to win the election before remedial measures, unavoidably disturbing to some elements of the electorate, had to be taken. The Labour Government could wait no longer. On October 26, it announced the following:

(1) A 15-percent surcharge was imposed on all imports, with the exception of foodstuffs, manufactured tobacco, fuel, and certain basic raw materials. (Estimated to save £300 million in imports and to raise about £200 million in taxes in a full year.)

(2) Goods exported after October 26 may be used as a basis for obtaining a tax rebate of certain indirect taxes. (Average rate estimated to be 1.5 percent and to cost the Exchequer about £75 million annually.)

(3) Government, management, and labor will consult to develop an effective income policy. (A price review body will be established.)

(4) Labor mobility will be encouraged by a system of subsidies. A new effort will be made to establish growth points.

(5) Government expenditures will be carefully screened to reduce the strain on the balance of payments and free resources for exports.

(6) Some prestige projects will be cut and others such as the Concord project will be urgently examined.

It became apparent by the beginning of November that a speculative crisis was in the making, adding to the difficulties of the pound. On November 11, the new Government announced a supplementary budget. This budget included the following:

(1) New measures, included hiking the standard rate of income tax by 6 pence to 8 shillings 3 pence, effective next fiscal year. (Revenues to be increased by £122 million in a full year.)

(2) Gasoline and diesel fuel for road vehicles are to be taxed at 3 shillings 3 pence, or 6 pence higher than heretofore. (Exchequer revenues expected to rise by £93 million in a full year.)

(3) As a first step to securing social justice for Britain, national insurance benefits and pensions are to be increased at a cost of £300 million a year with the Exchequer bearing about £85 million a year. Termination of prescription charges and improvement of national assistance benefits will each cost the Exchequer about £23 million in a full year.

(4) In addition Chancellor Callaghan announced that his April budget would include a new capital gains tax and a corporation tax. The latter measure will consolidate the income and profit taxes. The aim is to levy taxes in such a fashion as to encourage reinvestment of earnings.

The new budget failed to ease the pressures on the pound. On November 20, the drain on sterling assumed crisis proportions. The Economist stated that "disappointment that the bank rate had remained unchanged and news that Britain had conceded an assurance to EFTA to start cutting its import surcharge in a matter of months intensified dealers' unwillingness to carry sizable sterling balances over the weekend." On Monday, November 23, the bank rate was increased from 5 percent to the crisis level of 7 percent. On Tuesday it became evident that the crisis had not abated. The Economist observed: "Just why Monday's 2-percent jump in the bank rate should have been read not as (an admittedly belated) indication of Labour's determination to defend the pound but, as it clearly was read, as a panic reaction, is difficult to understand. To

some extent it must be chalked up to a wholly irrational distrust and dislike of Labour policies on the Continent."

Already by late Tuesday, moves were initiated to generate new lines of international credit to defend sterling. The Economist wrote: "Once it became clear on Tuesday that the previous day's belated but sharp rise in bank rate to 7 percent had still not quelled the doubts, further action was imperative: at the rate money was flooding out of London the Bank of England could hardly have faced another weekend. Its end-October reserve of £876 million was already at its 1961 low point and already partly pledged to repay foreign borrowings: net of these the reserves on Wednesday may have been down to the intolerable level of £500–£550 million, sinking hourly."

Within 24 hours the British were able to muster the largest short-term credits for exchange rate support in history. Nine members of the Group of Ten (Britain is the 10th), Austria, Switzerland, and the BIS provided $3 billion on 3- to 6-month terms to back up Britain's determination to defend the pound sterling. In addition, Britain will draw $1 billion from the IMF under an existing standby, or line of credit. The total increase in credit available to the British as a result of these borrowings is expected to be less than $4 billion, however, because of its announced intention to use the Fund drawing to pay off all previous drawings on credits from central banks including the Federal Reserve. The exact amount of the sums to be repaid is not known, so it is possible to conclude no more than that the net increase in British lines of credit is somewhere between $3 and $4 billion. The United States alone raised its existing swap with Britain from $500 to $750 million and added a $250 million credit from the Export-Import Bank.

The New York Times reported that the run on sterling stopped within an hour of the announcement at 2 p.m. on Wednesday, November 25, of the massive support from the international financial community.

The new Labour government has thus bought time in which to find a solution for the British balance-of-payments problem. The main outlines of its approach are not yet clear.

Sources: J. C. R. Dow, "The Management of the British Economy," Cambridge University Press, 1964; International Monetary Fund, annual report, various years; Bank for International Settlements, annual report, various years; The Ecoomist, various issues.

The British international liquidity position

[Data in millions of dollars]

Year end	British reserves				IMF standby [2]	External sterling liabilities
	Gold	Convertible currencies	IMF gold tranche position [1]	Total		
1948	1,611	398		2,009		13,783
1949	1,321	431		1,752		[3] 9,568
1950	2,862	581		3,443		10,486
1951	2,172	202		2,374		10,671
1952	1,483	475		1,958		9,624
1953	2,263	283	124	2,546		10,382
1954	2,530	268	236	2,798		10,368
1955	2,012	144	236	2,156		10,013
1956	1,773	503		2,276	739	9,582
1957	1,555	819		2,374	739	9,164
1958	2,807	298		3,105	739	9,377
1959	2,514	222	65	2,801		9,820
1960	2,801	430	488	3,719		10,872
1961	2,267	1,051		3,318	920	9,929
1962	2,581	225	502	3,308	498	10,576
1963	2,484	173	489	3,147	511	11,284
1964 (2d quarter)	2,439	266	491	3,196	509	11,934

[1] The gold tranche position measures the amount that may be drawn virtually automatically from the Fund.
[2] The IMF standby is an open line of credit with the Fund.
[3] The sharp decline from 1948 is attributable mainly to a writing-down of sterling liabilities as a result of the 30 percent sterling devaluation.

Sources: IMF, International Financial Statistics, various issues.
IMF, International Financial Statistics: Supplement to 1964–65 issues.

£ million

GENERAL BALANCE

	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957
A Current Account												
VISIBLE TRADE												
1. (a) Imports (f.o.b.)	1,082	1,560	1,794	1,978	2,390	3,501	2,959	2,896	3,020	3,432	3,462	3,573
(b) Exports and re-exports (f.o.b.)	920	1,146	1,604	1,847	2,254	2,752	2,831	2,677	2,825	3,076	3,411	3,517
Total	−162	−414	−190	−131	−136	−749	−128	−219	−195	−356	− 51	− 56
INVISIBLES												
2. Government: (a) debits	−487	−278	−172	−174	−165	−192	−217	−218	−229	−241	−258	−248
(b) credits	+164	+129	+ 96	+ 35	+ 29	+ 42	+165	+162	+105	+105	+ 91	+105
3. Shipping: (a) debits	−140	−169	−175	−187	−180	−280	−294	−242	−253	−341	−412	−444
(b) credits	+169	+205	+255	+282	+321	+412	+404	+376	+402	+464	+517	+554
4. Interest, profits and dividends: (a) debits	− 81	− 93	−101	−101	−112	−158	−198	−211	−231	−269	−259	−251
(b) credits	+162	+186	+192	+200	+271	+305	+289	+286	+310	+346	+373	+361
5. Travel: (a) debits	− 42	− 76	− 66	− 75	− 85	−104	− 83	− 89	−101	−125	−129	−146
(b) credits	+ 13	+ 21	+ 33	+ 42	+ 61	+ 75	+ 80	+ 88	+ 95	+111	+121	+129
6. Migrants' funds, legacies and private gifts (net)	+ 16	− 35	− 34	− 21	+ 5	− 14	− 15	− 4	− 6	− 18	− 18	− 33
7. Other (net)	+ 93	+ 82	+169	+168	+288	+244	+224	+250	+314	+251	+283	+301
Total	−133	− 28	+197	+169	+433	+330	+355	+398	+406	+283	+309	+328
CURRENT BALANCE	−295	−442	+ 7	+ 38	+297	−419	+227	+179	+211	− 73	+258	+272
B Special Grants												
8. (a) E.R.P. less U.S. share of counterpart	—	—	+144	+244	+239	+ 54	—	—	—	—	—	—
(b) I.E.P.A., E.P.U. (net)	—	—	− 6	− 46	− 95	—	—	—	—	—	—	—
(c) Australian and New Zealand gifts	—	+ 30	—	+ 16	—	—	—	—	—	—	—	—
(d) Revaluation payments by U.K.	—	—	—	− 60	− 4	− 11	—	—	—	—	—	—
TOTAL	—	+ 30	+138	+154	+140	+ 43	—	—	—	—	—	—

C Long-Term Capital Account												
9. (*a*) Inter-government loans by U.K. (net)	+ 5	−102	− 22	− 5	+ 16	− 9	+ 16	+ 26	+ 34	− 5	+ 19	+ 13
(*b*) Inter-government loans to U.K. (net)	+242	+763	+326	+ 6	− 30	− 59	− 16	− 57	− 54	− 48	− 70	+ 59
10. Subscriptions to I.B.R.D. and I.M.F.	− 33	−354	—	−173	—	—	—	—	—	—	—	—
11. 12. 19. } Other long-term and miscellaneous capital (net) and balancing item	+ 99	−301	−167	−207	− 81	−266						
11. Other long-term capital (net)							−180	−210	−220	−130	−190	−280
BALANCE OF LONG-TERM CAPITAL							−180	−241	−240	−183	−241	−208
Balance of current and long-term capital transactions							*+ 47*	*− 62*	*− 29*	*−256*	*+ 17*	*+ 64*
D Monetary Movements												
12. Miscellaneous capital (net)							+ 60	+ 30	+ 10	+ 60	− 70	+ 10
13. Overseas sterling holdings of:												
(*a*) countries	+ 43	−112	−346	− 9	+340	+ 94	−358	+274	+210	−127	−155	−151
(*b*) I.M.F.	—	+328	+ 9	+148	—	− 10	—	− 56	− 40	—	+202	+ 2
(*c*) other non-territorial organisations	+ 26	+ 34	+ 1	+ 30	+ 1	− 1	+ 1	—	+ 5	− 7	− 2	− 26
14. U.K. balance in E.P.U.	—	—	—	—	− 80	+246	+ 53	− 21	− 78	+ 1	+ 4	+ 11
15. U.K. official holdings of non-dollar currencies	− 33	+ 4	− 1	+ 15	− 28	+ 37	− 26	+ 30	− 3	—	− 1	− 22
16. Gold and dollar reserves	− 54	+152	+ 55	+ 3(1)	−575	+344	+175	−240	− 87	+229	−42(2)	−13(2)
TOTAL							− 95	+ 17	+ 17	+156	− 64	−189
BALANCE OF LONG-TERM CAPITAL, MONETARY MOVEMENTS AND BALANCING ITEM	+295	+412	−145	−192	−437	+376						
F 19. Balancing Item							+ 48	+ 45	+ 12	+100	+ 47	+125

SOURCE: HMG CENTRAL STATISTICAL OFFICE, UNITED KINGDOM BALANCE OF PAYMENTS, 1964.

General balance of payments

£ million

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963
Current account												
VISIBLE TRADE												
Imports (f.o.b.)	3,048	2,927	2,989	3,386	3,324	3,538	3,366	3,624	4,119	4,019	4,066	4,335
Exports and re-exports (f.o.b.)	2,769	2,683	2,785	3,073	3,377	3,509	3,407	3,522	3,733	3,892	3,994	4,286
Net	−279	−244	−204	−313	+ 53	− 29	+ 41	−102	−386	−127	− 72	− 49
INVISIBLES												
Government												
Debits	219	220	231	244	264	253	281	276	335	378	400	429
Credits	165	162	105	105	92	106	57	43	49	43	37	42
Transport												
Shipping												
Debits	425	447	484	570	659	652	586	602	666	667	659	671
Credits	559	535	520	540	611	659	629	618	634	639	647	660
Civil aviation												
Debits	38	39	38	40	45	52	60	64	78	86	94	101
Credits	38	41	38	37	44	49	68	82	96	106	114	124
Travel												
Debits	83	89	101	125	132	146	152	164	186	200	212	244
Credits	80	88	95	111	121	129	134	144	171	181	192	199
Other services												
Debits	182	174	183	187	200	226	222	239	263	264	271	275
Credits	304	300	345	358	379	406	415	440	466	499	503	494
Interest, profits and dividends												
Debits	248	266	290	343	342	334	389	396	431	410	407	405
Credits	500	493	539	516	569	579	686	666	665	654	736	782
Private transfers												
Debits	65	61	66	82	109	110	97	96	97	99	109	126
Credits	63	72	76	80	91	90	102	99	103	108	110	112
Total invisibles												
Debits	1,260	1,296	1,393	1,591	1,751	1,773	1,787	1,837	2,056	2,104	2,152	2,251
Credits	1,709	1,691	1,718	1,747	1,907	2,018	2,091	2,092	2,184	2,230	2,339	2,413
Net	+449	+395	+325	+156	+156	+245	+304	+255	+128	+126	+187	+162
CURRENT BALANCE	+170	+151	+121	−157	+209	+216	+345	+153	−258	− 1	+115	+113

Long-term capital account (1)												
Inter-government loans (net)	—	− 30	− 20	− 52	− 50	+ 75	− 44	−118	− 92	− 16	− 91	− 97
U.K. subscriptions to I.F.C., I.D.A. and European Fund..................	—	—	—	—	− 5	—	—	− 4	− 10	− 9	− 9	− 9
Other United Kingdom official long-term capital (net)	− 20	− 19	− 8	− 10	− 13	− 9	− 6	− 2	—	− 20	− 4	+ 1
Private investment												
Abroad	−127	−173	−238	−182	−258	−298	−307	−311	−314	−321	−253	−309
In the United Kingdom	+ 13	+ 28	+ 75	+122	+139	+126	+165	+176	+228	+416	+250	+259
BALANCE OF LONG-TERM CAPITAL........................	−134	−194	−191	−122	−187	−106	−192	−259	−188	+ 50	−107	−155
Balance of current and long-term capital transactions	+ 36	− 43	− 70	−279	+ 22	+110	+153	−106	−446	+ 49	+ 8	− 42
Balancing item	+ 59	+ 26	+ 53	+123	+ 41	+ 97	+ 49	− 67	+256	− 29	+ 84	−111
Monetary movements (1)												
Miscellaneous capital (net)	+ 18	+ 29	+ 43	+ 59	− 45	+ 11	− 6	+ 37	+119	− 8	+126	− 32
Change in liabilities in non-sterling currencies (net)........................												− 17
Change in liabilities in overseas sterling area currencies (net)	−315	+275	+182	−133	−181	−195	+ 84	+133	+397	−356	− 23	− 7
Change in external liabilities in sterling (net)												+151
Change in official holdings of non-convertible currencies	− 26	+ 30	− 3	—	− 1	− 22	+ 23	+ 8	+ 2	+ 1	+ 1	—
Change in U.K. balance in E.P.U....	+ 53	− 21	− 78	+ 1	+ 4	+ 11	− 10	+ 9				
Change in account with I.M.F.	—	− 56	− 40	—	+202	+ 1	− 9	−133	−151	+374	−379	+ 5
Change in gold and convertible currency reserves	+175	−240	− 87	+229	− 42	− 13	−284	+119	−177	− 31	+183	+ 53
BALANCE OF MONETARY MOVEMENTS	− 95	+ 17	+ 17	+156	− 63	−207	−202	+173	+190	− 20	− 92	+153

(1) Assets: increase −/decrease +. Liabilities: increase +/decrease −

SOURCE: HMG CENTRAL STATISTICAL OFFICE, UNITED KINGDOM BALANCE OF PAYMENTS, 1964.

Balance of payments

£ million

	Current account					Long-term capital account(1)			Balance of current and long-term capital transactions	Balancing item	Monetary movements(1)				
	Imports (f.o.b.)	Exports and re-exports (f.o.b.)	Visible balance	Invisible balance	Current balance	Official investment (net)	Private investment (net)	Balance of long-term capital			Miscellaneous capital (net)(2)	Change in external liabilities in sterling (net)(3)	Change in account with I.M.F.	Change in gold and convertible currency reserves	Balance of monetary movements
1958 ...	3,366	3,407	+ 41	+304	+345	− 50	−142	−192	+153	+ 49	+ 7	+ 84	− 9	−284	−202
1959 ...	3,624	3,522	−102	+255	+153	−124	−135	−259	−106	− 67	+ 54	+133	−133	+119	+173
1960 ...	4,119	3,733	−386	+128	−258	−102	− 86	−188	−446	+256	+121	+397	−151	−177	+190
1961 ...	4,019	3,892	−127	+126	− 1	− 45	+ 95	+ 50	+ 49	− 29	− 7	−356	+374	− 31	− 20
1962 ...	4,066	3,994	− 72	+187	+115	−104	− 3	−107	+ 8	+ 84	+127	− 23	−379	+183	− 92
1963 ...	4,335	4,286	− 49	+162	+113	−105	− 50	−155	− 42	−111	− 56	+151	+ 5	+ 53	+153
1962 1st qtr.	1,021	987	− 34	+ 74	+ 40	− 10	+ 42	+ 32	+ 72	+ 62	+135	−132	− 89	− 48	−134
2nd qtr.	1,017	1,036	+ 19	+ 55	+ 74	− 15	− 24	− 39	+ 35	− 11	− 16	+ 77	− 92	+ 7	− 24
3rd qtr.	997	942	− 55	+ 25	− 30	− 28	− 10	− 38	− 68	+ 93	− 7	− 51	−196	+229	− 25
4th qtr.	1,031	1,029	− 2	+ 33	+ 31	− 51	− 11	− 62	− 31	− 60	+ 15	+ 83	− 2	− 5	+ 91
1963 1st qtr.	1,040	1,057	+ 17	+ 77	+ 94	− 11	− 52	− 63	+ 31	− 7	+ 78	− 99	—	− 3	− 24
2nd qtr.	1,068	1,087	+ 19	+ 49	+ 68	− 10	—	− 10	+ 58	− 38	−110	+ 51	+ 3	+ 36	− 20
3rd qtr.	1,077	1,017	− 60	+ 18	− 42	− 25	− 6	− 31	− 73	− 1	− 9	+ 89	+ 2	− 8	+ 74
4th qtr.	1,150	1,125	− 25	+ 18	− 7	− 59	+ 8	− 51	− 58	− 65	− 15	+110	—	+ 28	+123
1964 1st qtr.	1,243	1,126	−117	+ 65	− 52	− 28	− 67	− 95	−147	+ 56	+ 45	+ 47	—	− 1	+ 91
2nd qtr.	1,252	1,154	− 98	+ 25	− 73	− 20	−101	−121	−194	+ 29	+ 98	+ 84	− 1	− 16	+165

(1) Assets: increase −, decrease +. Liabilities: increase +, decrease −.

(2) Also includes changes in U.K. liabilities in non-sterling currencies (net), in official holdings of non-convertible currencies, in U.K. balance in E.P.U. and from the beginning of 1963, in U.K. banks' liabilities in overseas sterling area currencies (net). Before 1963, liabilities in overseas sterling area currencies formed part of overseas sterling holdings.

(3) Excluding liabilities to the I.M.F. Figures for periods before 1963 are changes in the net total of overseas sterling holdings (other than by the I.M.F.) and sterling acceptances outstanding.

Source: Central Statistical Office

Reserves and net liabilities in sterling

End of period

£ million

	Gold and convertible currency reserves	External sterling liabilities (net)							
		Total	International organisations(1)	Sterling area countries	Non-sterling countries				
					Total	North America	Latin America	Western Europe	Other
1962 ...	1,002	3,536	606	2,290	640	83	−63	488	132
1963 1st quarter ...	1,005	3,437	608	2,334	495	69	−66	347	145
2nd quarter ...	969	3,491	611	2,406	474	83	−59	354	96
3rd quarter ...	977	3,582	609	2,450	523	76	−52	401	98
4th quarter ...	949	3,692	627	2,461	604	73	−55	458	128
1964 1st quarter ...	950	3,739	625	2,510	604	81	−49	445	127
April ...	969	..	..	..	..	..	..	..	..
May ...	986	..	..	..	..	..	..	..	..
June ...	966	3,822	621	2,580	621	109	−32	428	116
July ...	956	..	..	..	..	..	..	..	..
August ...	923	..	..	..	..	..	..	..	..
September ...									

(1) Including I.M.F.

Source: H.M. Treasury and Bank of England

SOURCE: HMG CENTRAL STATISTICAL OFFICE, UNITED KINGDOM BALANCE OF PAYMENTS, 1964.

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