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JANUARY 1965 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

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THE PRESIDENT'S ECONOMIC REPORT

WEDNESDAY, FEBRUARY 24, 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 and Proxmire; Representatives Patman, Reuss, Griffiths, and Ellsworth.

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

Chairman PATMAN. The committee will please come to order. We are privileged this morning to have with us two of the ablest and best known economists in the world today, John Kenneth Galbraith, professor of economics at Harvard University, and Seymour Harris, professor of economics at the University of California, and Lucius N. Littauer professor of political economics, emeritus, at Harvard University. The advice and counsel of these distinguished advisers will be of great assistance to the members of the committee in our deliberations on the President's Economic Report. In line with the committee's usual practice, witnesses will make their statements without interruption and then questioning will proceed under the 10-minute rule.

Our first witness, Professor Harris, has been adviser to numerous Government officials and agencies, including the Secretary of the Treasury. He is the author of some 42 books, the latest of which is "Economics of the Kennedy Years." We welcome you, Dr. Harris. We are delighted to have you here, sir.

STATEMENT OF SEYMOUR HARRIS, PROFESSOR OF ECONOMICS, THE UNIVERSITY OF CALIFORNIA, AND LUCIUS N. LITTAUER PROFESSOR OF POLITICAL ECONOMICS, EMERITUS, HARVARD UNIVERSITY

Mr. HARRIS. Thank you, Mr. Chairman. Since you have identified me I will skip my second long paragraph and say that, as usual, I am pleased to testify before this knowledgeable committee. And, as usual, I speak for myself only.

Just a word about the general assessment of the Kennedy-Johnson economics. The achievements of the Kennedy-Johnson administration through their interventions in the economy have surpassed those of any administration in our history. On top of that, we have had the most able and distinguished Council of Economic Advisers in our history. It is hard to see how Professors Heller, Tobin, Ackley, Eckstein, and Okun could be improved upon.

In the Treasury, we have a Secretary as able as any since Hamilton. The 1965 Economic Report is a superb document with which I am very largely in agreement.

ACCEPTANCE OF THE NEW ECONOMICS

For the first time, a President of the United States (both Kennedy and Johnson) and the Congress have accepted the implications of modern fiscal policy. Moreover, a large section of the business community now supports the new economics, with the head of the country's largest bank reassuring his financial colleagues that deficit financing is not a danger, and the debt is at a safe level.

It has taken about 35 years since Keynes first began to press the relevant ideas, with some help from many of us here, that men in authority have finally put these ideas to work.

This intervention by Government is the distinguishing characteristic of the years 1961–64; and the openmindedness of these men accounts for a large part of the gains of $122 billion of GNP.

THE COUNCIL REPORT

In the Council report, I draw the attention of the committee especially to the excellent discussions of how fiscal policy has worked and its potential; the need of fiscal policy and complementary monetary policy to treat the surplus at full employment insofar as private demand cannot cope with it; the contributions of fiscal policy to the recovery and advance of 1961–64; and the need of additional stimuli in 1965 and especially in 1966; the deficiency of actual to potential output,[1] its cause and cure; the price problem and especially its relation to wages, productivity, and unemployment; and the excellent comparisons of the two recoveries under Eisenhower[2] with the 1961–64 recovery, and why the earlier recoveries were less satisfactory.

THE ACHIEVEMENTS OF THE KENNEDY-JOHNSON ADMINISTRATION IN DETAIL

a. The rise of GNP

The increase of $122 billion, or 24 percent, in current dollars from 1960 to 1964 or $91 billion, or 17 percent, in 1964 dollars is a fine performance. (The Council puts the annual gain from 1961 (first quarter) to 1964 (fourth quarter) at 6.5 percent or 5 percent in stable prices.)

It is even more striking if the 26-percent rise of GNP (Council) is compared to a 5-percent increase of prices, or a ratio of 5-to-1 increase of GNP (good) to the rise of prices (bad). This should be compared with a 2¾-to-1 ratio for Eisenhower from 1952–60.

[1] 1965 Economic Report of the President, p. 82.
[2] Ibid., pp. 56, 109.

b. Duration of recovery

This promises to be a record recovery, and especially since the gains have been not from the low level of 1933, but from the relatively high level of 1960. We are now in our 48th month of recovery. The 3 preceding ones were 45 (Korea), 35, and 25 months. Over 104 years, the average recovery was 26 months. The leading indicators point to continued recovery in 1965.

c. The business cycle is out?

Occasionally optimistic statements of this sort come out of Washington. (I believe the Council is a little optimistic here.) But a safer position is that through appropriate Government action the declines may be postponed and their extent reduced. Incidentally, both rises and declines per month in the years since 1948 have been more moderate than in earlier years.

d. The rate of interest

This is a unique recovery in that we have been moving ahead for 4 years and the rate of interest has scarcely changed net, except in the short-term Treasury market, a rise related to the dollar problem.

Corporate Aaa bonds, for example, yielded 4.41 percent in 1960 and 4.40 percent in 1964.

In the years 1952–60 there were steady rises (2.96 in 1952 to 4.41 in 1960) punctuated by moderate declines in the recession years 1954 and 1958,[3] Arthur Burns noted that the rise of rates in 1958–59 was a record one over 100 years of recorded history.

e. Prices

I do not know any period in modern American history when, with a recovery of these proportions, prices have remained so stable.[4] Wholesale prices were unchanged and consumer prices rose by 1¼ percent a year, an increase that may be written off if allowances were made for improvements in quality and increased choice.

The Eisenhower record, despite the great anti-inflation campaign, was 1½ percent average for 8 years and 8 percent for the years 1956–59.

f. Wage policy

The Kennedy-Johnson administration used moral suasion to keep wages from rising excessively. Hence, wage rates in manufacturing under a Democratic regime rose only 3 percent a year. Under Eisenhower the increase was close to 5 percent per year. In 1964, wages rose by 3¾ percent and productivity also 3½ percent.

Why the difference? President Eisenhower allowed wages to rise without any action from him. He had either to contain the rise of wages, or as wages rose and then prices, he had to accept higher prices or try to restrain the increase by restricting monetary supplies. The restrictionist monetary policy was costly. The administration ended up by having both higher prices and large amounts of unemployment as through monetary restrictions the Government tried not to validate the rise of wages.

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[3] Ibid., p. 67.
[4] Ibid., p. 56.

Kennedy was aware of this dilemma, and hence introduced his guidelines.[5]

Mr. Chairman, I would like to point out the Council did a wonderful job in fiscal policy. I would also like to point out that some of the ideas floating around in 1961 were first broached by the members of this Committee and members of the staff and particularly Mr. Knowles.

I don't think they have had adequate credit for their great achievements in bringing the ideas to the fore since 1950.

g. Advances in fiscal policy

The tax cut was one of the great achievements of modern public policy. Its contribution to rising demand in 1964 may well have increased GNP by $15 billion in that year and $30 billion ultimately. The Council put its achievement somewhat more modestly, about $12 billion.

In 1965, the stimulus will be substantially less than in 1964. In the first half of 1966, current commitments point to a net deflationary effect of more than $3 billion as a result largely of a heavy rise of social security taxes.

Additional measures seem needed. At any rate, the 1964 economy benefited by as much as 40 percent of the rise of GNP because of the new fiscal policies.

The Council is estimating, I might say, one-third.

h. The fiscal drag

The Kennedy administration became aware of the increasing take of taxes as recovery moved ahead, a diversion of purchasing power from the spending stream which meant large surpluses at full employment.

It was necessary to treat the drag. Under K–J there was a steady average deficit of about $7 billion in the administrative budget, which kept the economy healthy. (Less under two other budgets.)

Under Eisenhower, deficits during each rise were followed by surpluses that helped abort the recovery.

i. Dependence on improved profit prospects

Since the administration was restricted by the international situation in its expansionist policies, the administration relied heavily on another technique: attracting the confidence of businessmen (and in part by fiscal policy), and improving profit prospects—e.g. through various tax measures, inclusive of the big tax cut and increased depreciation allowances.

Why some businessmen disapproved of President Kennedy will always be a mystery. In fact, President Kennedy did more for the businessmen than Eisenhower ever did.

Improved prospects were a substitute for greater declines in the rate of interest.

j. Judicious use of deficits

From fiscal year 1961 to 1965 (estimated), the national debt rose by $28 billion. I see no reason for alarm. Prices have been stable; the increase of debt was but 23 percent of that of GNP and the additional

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[5] Ibid., pp. 54–57, 108–110.

cost of financing the debt little more than $1 billion yearly. We should compare that figure with the rise of GNP of $30 billion a year, to which the deficit may well have contributed half or more. In relation to GNP, the debt declined from 57.3 to 49.5 percent.

I might say the relationship was 133 percent of debt to GNP in 1946.

k. Debt management

The administration managed to lengthen the average maturity of the debt; and in contrast to Eisenhower policies, did not issue long-term securities in recovery periods which would absorb the new funds being created, thus weakening the recovery forces—e.g., the first half of 1958.

l. Unemployment

The record here is not outstanding. Yet unemployment dropped from almost 7 percent early in 1961 to less than 5 percent recently. The figure is still too high. Moreover, the distribution is unfortunate—e.g., 5 percent for all, 15 percent for the young and 30 percent for young Negroes, and a rate twice as high for all nonwhites as for whites. But fortunately, only 2.8 percent for married men living with wives.

m. Why is unemployment so high?

The public is not ready to accept an adequate fiscal policy, which will increase demand sufficiently to bring unemployment down to 3–4 percent.

A second problem is the large rise of demand (or GNP) required to induce a given increase in the number of jobs. With 2 million workers being displaced by rising productivity annually, and 1½ million additional (net) workers, demand must rise by perhaps $25 billion to keep unemployment from rising.

It takes much greater rises of demand to yield additional jobs than in the past.

In one sense the unemployment statistics underassess the costs; for with much employment many withdrew from the market and hence, though wanting jobs, are not included in the unemployed.

n. Structural attack on unemployment

Here much progress with the area redevelopment program, for which Senator Douglas was largely responsible, the Appalachian program, the Manpower Training and Development Act, and the antipoverty program are all splendid ideas and promise dividends in higher incomes and more jobs. Educational programs are beginning to move forward under the able guidance of Commissioner Keppel, and the net effect should be higher incomes and less unemployment.

That an additional job in such programs may cost only $1,000–$2,000 as against $10,000, on reasonable assumptions, under the deficit route is a strong argument for these programs, but their effectiveness is reduced by three factors:

1. Inadequate funds.
2. With a modest number of unfilled vacancies, which set an upper limit on the additional jobs to be had, the rise of jobs is limited.
3. The greater significance of the demand or deficit attack. In eight industries that lost 2½ million out of 7½ million jobs in 13 postwar

years, the losses were eight times (average) as large in 4 years of unsatisfactory demand as on the average in the 9 good years, an indication of the overriding importance of demand and fiscal policy.

o. The dollar problem

The Government has made some progress, but not enough. How much depends on the measures used.

1. Large improvement on the basis of gold drains:
   Average annual loss of gold, 1957–60—$1.25 billion.
   Average annual loss of gold, 1961–64—$0.60 billion.
2. Excess of exports of goods and services: Points to a great improvement in competitive position.
   Excess of exports, goods and services, annual 1957–60—$3 billion.
   Excess of exports, goods and services, annual 1961–64—$6 billion.
3. Deficits measured by loss of gold and sales of dollars to foreign governments and central banks—Johnson message of February 10, 1965—which is a method frequently used by foreign countries in measuring their deficits. The improvement is from 1962, a deficit of $3.3 billion; 1964, $1.3 billion.
4. But the balance limited to regular transactions (for example, eliminate such items as debt prepayments to the United States) improves only from minus $3.9 billion in 1960 to minus $3.25 billion in 1961–64. With receipts from special transactions, the gain is from minus $3.9 billion in 1960 to about minus $2.5 billion average in 1961–64.

As the President in his February 10, 1965, statistics made clear, the villain is capital movements.

The large gains of exports, reduced purchases abroad with aid money, and rising income from profits and interest from abroad—$3½ billion—were largely offset by a rise of $2½ billion of private capital outflow.

PROBLEMS OF 1965 AND LATER YEARS

a. Monetary policy

There is real danger that dear money may be introduced prematurely. There have been rumblings and warnings of higher rates for years, and especially from financial groups and notably the head of the New York Fed. Fortunately, the administration has not yielded, and Mr. Martin has wisely gone along.

President Johnson has wisely refused to allow the balance-of-payments problems to end our recovery through rising rates. "I expect the continuation of essential stability in interest rates" (February 10, 1965). It is imperative that the monetary authority be not swayed by temporary factors to raise interest rates, and especially while GNP is rising at a rate of $30 to $40 billion per year.

Mr. Chairman, I would like to point out that a good deal of pressure for higher rates comes not from financial people in this country, but even more so from financial people abroad. They are now, for example, claiming that the only way to deal with our balance-of-payments problem is to reduce the supply of money. They have their hands on $15 billion of short-term dollar assets.

If we should suddenly, for example, introduce a deflationary policy and cut down the supply of dollars, then their chances of converting the dollars into gold at the present rates would be increased. They don't care nearly as much as the American financial people do about the general health of this economy. They are even more aggressive in their determination to have higher rates. Ever since 1963 they have been advising us to have higher rates of interest. If we had taken their advice, we would have really been in trouble in 1964 and 1965.

In this connection, Congressman Patman has served his country well in persistently opposing the finance men who so often want higher rates prematurely. His influence over 40 years has been toward sensible rates; therefore, more investment and output. Financial groups seem to believe that the higher the price of their product, the more profits.

They exercised excessive influence in the 1950's when long-term rates rose by two-thirds. But in my opinion they will do better with lower rates. Their attitude toward restrictive monetary policy since 1961 only strengthens the case for the exclusion of the Federal Reserve bank presidents from the Open Market Committee, as Congressman Patman so effectively argues.

Their demand for higher rates following President Johnson's message of February 10 again emphasizes the need of leadership by Congressman Patman and others for those who see the problem in terms of what is good for the Nation.

b. The independence of the Federal Reserve

The Federal Reserve cannot and should not be independent. Senator Douglas, in his decisive influence in bringing about the accord of the early 1950's, emphasized the only significant aspect of this problem: Monetary policy should be determined by the needs of the country, not merely of the Treasury.

But I am sure it was not Senator Douglas' view that what the country needed was 4- to 5-percent money instead of 2½ percent. No one has been more vigilant and sensible in the fight against an independent Fed than Congressman Patman.

I used to think that the Fed and Mr. Martin in particular were responsible for the high and destructive money rates of the 1950's. But I was unfair. I am sure now that this was administration policy. President Eisenhower feared inflation and, hence, the administration's dear money policy. The Fed went along, just as in 1961–64. Presidents Kennedy and Johnson saw the wisdom of adequate money and low rates. Mr. Martin went along. He is too smart to hold the view that the administration can go one way and the Fed another.

c. Budgetary problems

Almost everyone who is knowledgeable sees need for continued stimulus of the economy through fiscal policy and continued adequacy of monetary supplies. Yesterday Budget Director Gordon made this clear, and suggested we were now at a $6 billion employment surplus level, which means we have to take further action to get rid of this surplus at full employment.

Demand must be high enough to take our potential output off the market at low rates of unemployment.

One of the great contributions of the Budget Director has been the shift of emphasis from the administrative budget to the cash and national income budget, for the administrative budget is the least relevant. What is especially significant is the continued rise of receipts despite the large tax cut and proposed excise tax cuts.

In the 2 fiscal years 1963–64 to 1965–66 receipts are to rise by $8 billion, and payments by $7 billion. My only question is whether a $4 billion excess of cash payments in fiscal year 1966 will be enough, or $5 billion on the national income account for calendar year 1965 will be adequate. I do not go along with a proposal by one influential group that expenditures should rise by $15 billion.

Rather, in view of the world situation, I would be more cautious. But tax cuts have received the large emphasis of late. Hence, I would be inclined to stress spending more than tax cuts and my budget would add at least $2 billion more of welfare outlays to the Johnson budget. This should have the approval of Professor Galbraith.

[Billions of dollars]

	1964 actual	1965 estimate	1966 estimate
Cash Federal receipts	115.5	117.4	123.5
Cash Federal payments	120.3	121.4	127.4
Debits	−4.8	−4.0	−3.9

The changing pattern of spending is a tribute to the Kennedy-Johnson administration. (Administrative budget.)

[Billions of dollars]

	Fiscal year 1964	Fiscal year 1966
Defense and space	58.4	56.7
Welfare programs	6.7	11.0

And as I said earlier, additional activity by the Government seems needed for 1966.

d. The balance of payments

As measured by gold losses, official deficits in the balance of payments and the excess of exports over imports, we have done well since 1961.

The most effective facets of the Kennedy-Johnson program have been—

(1) Continuing price stability.

(2) Tying aid to American exports.

(3) The interest equalization tax as a means of discouraging exports of capital.

(4) Improved economic conditions.

For under a new theory developed by the administration, prosperity would be accompanied by an improvement in the balance of payments: Less capital would go out and more come in. The accepted theory had been greater growth means more imports and less exports. Undoubtedly there were gains on the capital side, but the net movements of capital were disappointing.

(5) The last contributions by the Government were the brilliant improvisations of Under Secretary Roosa to increase international reserves.

I would like to point out that a long time ago we were told that if the country's growth were in excess of the growth of other countries an unfavorable balance of payments would prevail because our imports would increase and exports would decline. The Council of Economic Advisers in 1961 developed a new theory that with more growth our balance of payments improves because of the rising productivity and lower prices.

I must say, on the basis of what has happened in the last few years, it may be desirable to look this theory over again and make sure the Council is right on this point.

I would have preferred a few other measures in the past: (1) A widening of the gold points—say, 2 percent each way as a means of discouraging speculative capital movements; (2) a removal of all reserve requirements for the Federal Reserve.

The proposed elimination of Federal reserves against deposits only is not adequate. The release of gold is, therefore, only about one-third of what it would be if all Federal Reserve requirements were eliminated. Here I agree with Senator Douglas.

I wish I had given you, Senator Douglas, this quote from Keynes that I have here. I think it might have helped a little. I know that Keynes is not always popular with all Congressmen. Let me quote Mr. Keynes 35 years ago:

> * * * But the legal reserves of the central bank merely lock away resources when they are useless, and the effective strength of a central bank entirely depends in practice on the amount of its excess reserves. Thus, we have the paradox that the more strictly and conservatively the gold reserves of a central bank are presented by law, the weaker it is and the more utterly exposed to disastrous disturbances from every wind which blows. A central bank which was compelled to keep 100 percent of its assets in gold would be not much better off than one which had no reserves at all.

Senator DOUGLAS. I appreciate this reference to me, but the facts of the matter are that Congressman Reuss preceded me by several weeks.

Mr. HARRIS. I am sorry.

Senator DOUGLAS. He led off on this as on several other matters.

Mr. HARRIS. I am a great admirer of Mr. Reuss, too, and Senator Douglas also, two of the best economists in the Congress. I think it is particularly an achievement for Mr. Reuss because I don't believe he had much economics in college.

Representative REUSS. Economics I.

Mr. HARRIS. Did you have Samuelson's book?

Representative REUSS. No.

The dollar tomorrow

Mr. HARRIS. (1) We should try again to get the Congress to discourage exports of capital by removing a special tax incentive which encourages these direct exports of capital—turned down by the Congress in the past. The rise of capital exports is very costly in exports of U.S. commodities, and, hence, in increasing current deficits.

(2) If that is inadequate, inclusive of the Johnson proposals of February 10, the next step should be a Capital Issues Committee to scrutinize capital movements. But the moral suasion approach should be tried first. If it does not work, control of all exports of capital will

be needed. Our exports of capital are too large for economic and political reasons.

(3) We should continue to press for increased international liquidity, and access to the Common Market.

f. Return to gold?

De Gaulle's recent proposals are insane. They are meant to embarrass us, with political objectives in mind. Since the problem is inadequate world liquidity and De Gaulle's proposals would mean the elimination of pounds sterling and the dollar as equivalent to and substitutes for gold, at one swoop De Gaulle would destroy $25 billion of the $65 billion of reserves. We should, of course, fight De Gaulle's attempt to embarrass the United States and bring on a worldwide deflation.

One development that irks De Gaulle is the increasing control of French industries by American interests. He seems to believe that a return to gold would reduce the expansion in the United States and further weaken the dollar and, hence, discourage exports of capital from here. This is at least one argument for eliminating the tax incentive to direct U.S. capital exports.

g. Inflation?

At present unemployment and excess capacity, there is not much danger, although I think the Council is a little optimistic on the continued rise of productivity. The emergency of bottlenecks and inflationary cost—and price—policies are relevant, and should be watched.

Thank you very much, Mr. Chairman.

Chairman PATMAN. The next witness is Professor Galbraith, who studied both in the United States and abroad, and holds, among other things, a doctor of philosophy degree from the University of California. He has also taught at Harvard and Princeton and served in a variety of capacities to different Government agencies.

Most recently, in 1961–63, he was the American Ambassador to India. He is the author of many books, including "The Affluent Society" and "The Liberal Hour."

Dr. Galbraith, it is a pleasure to have you with us. You may proceed in your own way, sir.

STATEMENT OF JOHN KENNETH GALBRAITH, PAUL M. WARBURG PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. GALBRAITH. Mr. Chairman, it is a pleasure to be back here with my old friends. May I say that I have considered that the report which you are considering in these hearings conforms to the high standards of technical competence and good sense which we have come to expect in these documents, and that there is very little either in the history or the current diagnosis or the projections which are offered by the report with which I would differ.

Accordingly, I should like to stress a few matters that seem likely to arise in the course of the coming year which are worth a word of extra emphasis or where I have some special concern or where there are some advantages in speaking without the constraints of official tact. I say this for I hope no one will imagine I am here as a critic of President Johnson or his economic advisers. I am very much on the same side.

I would hope, with Professor Harris, that a highly skeptical eye would be kept on the inevitable proposals to advance interest rates as they will be made from month to month during the coming year. Income promises to remain high; savings, both personal and corporate, will, in consequence, continue to be large.

This is a happy conjunction for the country. It is not so well regarded by those with money to lend, for it means that the normal tendency of interest rates is to be low. Low interest rates are not more beloved by those receiving them than low wheat prices or low cotton prices or even low cattle prices. There is a difference, however.

Interest rates are the only price that is never raised in order to give the recipient a greater return. They are always raised as a somber act of national policy. The fact that those with money to lend receive more—and those who must borrow pay more—is purely incidental. One shouldn't really mention such things.

Like most economists, I am an admirer of the Federal Reserve System. It performs its various services with a grace that is becoming to the vast sums involved. I do confess to wondering, however, why, in this age of abundant savings, it is so all but invariably the voice for higher rates.

Over the last 15 years, it is hard to recall any occasion when the Federal Reserve was known to be agitating for lower interest. We have come to envisage the Open Market Committee as a group of men of excellent character and reassuring demeanor who meet to consider whether there is a good reason for tighter money. Perhaps this only reflects a failure in public relations. If so, during the coming year Chairman Martin may wish to correct the impression by letting it be known, at appropriate intervals, that he is fighting indomitably to keep down the cost of money.

During the coming year, most of the argument for increased interest rates will be on behalf of the payments balance. This has been true, in fact, ever since excessive and ill-considered increases precipitated the recessions in the fifties. It is, of all balance-of-payments remedies, the worst in our situation. Its principal effect is on the cosmetic aspects of the problem, not on the fundamental questions of the trade balance or oversea spending or long-term capital movements, but merely on where short-run balances that result from the foregoing transactions are held.

To the extent that interest-rate policy does reach down and affect fundamentals, it depresses investment in this country, a result few would welcome. There was no occasion for the increase in the rediscount rate last autumn at the time of the British crisis. It was merely the automatic response to an excuse to raise rates.

The balance-of-payments problem has never been one of fundamental difficulty. It has been exclusively one of overpowering reluctance to take the firm but fairly elementary action that improvement requires. Every department of Government has been inordinately impressed with the advantages of having some other agency take the action and, thus, accept the inconvenience, discomfort, or pain that is involved in reversing accustomed policies. The step now being taken to control long-term portfolio and direct lending and bank lending is a proper one and greatly overdue.

I agree fully with Professor Harris' diagnosis here.

If a bank is feeling pressed on liquid assets, it does not go out and invest in long-term bonds or mortgages. The position of the country is analogous. However, I am dubious about the voluntary aspects of the proposal. This is the normal recommendation of those who seek to avoid arbitrary action. It is also the normal reaction of those who hope that nothing will be done.

In practice, where a strongly adverse economic interest is involved, it is the most arbitrary of procedures. It penalizes the cooperative man of conscience. It rewards the indifferent or obstinate moneymaker who concludes that such cooperation is unfair interference with his liberties and profits.

Fair and equitable rules, fairly enforced, which are a very old idea, are much better. Other countries employ them to control capital outflow; we shall probably have to use them, too, and better sooner than later. To place matters like this on a voluntary basis with businessmen is much the same as putting the closing of veterans' hospitals on a voluntary basis with Senators.

Incidentally, the appropriate control here is the establishment of the Capital Issues Committee for which legal authorization does exist and on that I agree with Professor Harris.

Representative REUSS. Legal authorization is the Trading With the Enemy Act?

Mr. GALBRAITH. Yes. It is an unfortunately labeled act but it does exist.

As a small personal footnote I might say here that I was, I imagine, as responsible as anyone else for cutting the tourist customs free allowance from $500 to $100 in 1961. I was worried then that we were taxing the purchases of the returning tourist while leaving untouched the oversea expenditures of the wealthy American who resides permanently abroad and who may spend more money in a year than the tourist—or oversea GI on whom we were also tightening down—sees in a lifetime. To cut the allowance now to $50 involves even more discrimination against the little man and in favor of the opulent expatriate in Cannes, Monte Carlo, Gstaad, St. Moritz, Paris, or the Bahamas.

As a matter of elementary equity, we should review the tax liabilities to which the wealthy expatriate is subject. A special 25-percent tax on income from dollar sources of nonworking Americans living abroad for more than 6 months of the year would be an admirable encouragement to spending more time and more dollars in Palm Beach, Newport, Westchester, Park Avenue, and other admittedly inadequate but still tolerable precincts.

I believe in being fair to the rich, including the idle rich. But I am still attracted to the ancient liberal notion that one should have an eye out for the average man. After we tax the person who spends $10,000 a year abroad, it will be time to tax the Kansas schoolteacher on what she spends on a trip in excess of $50.

I have the impression that the American people, in electing so many liberal Congressmen last autumn, had in mind that they would have an eye for minor decencies of this sort.

III

The guideposts on wages and prices are central to the defense of the dollar. And they are important for domestic tranquility and our reputation for good economic management. Adherence to these guideposts is overwhelmingly the reason for the stable prices of these last years—as compared with the steady inflation of the fifties in the United States or that of the Common Market countries in recent times.

The guideposts are observed because they are to the common advantage of labor and the corporations. The unions do not have to exhaust their bargaining resources in chasing living costs; improvements that they win are genuine. Corporations have a stable rather than an inflationary pattern of prices and costs for their planning and do not have to contend with the annoyance of customers with prices that are going up.

Since observance of the guideposts is broadly consistent with the longer range economic interests of unions and firms, there is a good chance that here voluntary restraint will work. It requires a clear public lead that can be followed to the common advantage of the individual firm and union and to the great advantage of the community.

This we have and it has been a great gain in economic management—perhaps the greatest gain, so far, of the Kennedy-Johnson years.

Economists have not fully credited the administration with this achievement; some have been unwilling to stress the importance of a measure that seemed somehow inconsistent with the totems of the free market.

Wage and price making within the guideposts is not yet secure. There is always the danger that some union or some corporation will sacrifice longrun advantage for a shortrun tactical gain. One of the most important tasks of the year ahead is to secure continued observance of the guideposts.

IV

I was never as enthusiastic as many of my fellow economists over the tax reduction of last year. The case for it as an isolated action was undoubtedly good. But there was danger that conservatives, once introduced to the delights of tax reduction, would like it too much.

Tax reduction would then become a substitute for increased outlays on urgent social needs. We would have a new and reactionary form of Keynesianism with which to contend.

This remains a danger. It would already be a grave one if Secretary McNamara had not done such a brilliant job of getting control of military expenditures. This has given some margin for increasing expenditures on social requirements. But we must continue to be wary of tax reduction at a time when so many public tasks of such urgency are awaiting attention.

I am not quite sure what the advantage is in having a few more dollars to spend if the air is too dirty to breathe, the water is too polluted to drink, the commuters are losing out on the struggle to get in and out of the cities, the streets are filthy, and the schools are so bad

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that the young, perhaps wisely, stay away, and hoodlums roll citizens for some of the dollars they saved in taxes.

In fact, this kind of economic policy defeats even the goal of full employment. For, increasingly, the problem of employment is not a deficiency of demand but unemployability that results from deficient education, preparation, or unrelieved social squalor. The unemployed today consist overwhelmingly of three overlapping groups.

The unemployed are the uneducated, as the Economic Report tells; it was last year 8.4 percent for those with less than 8 years of schooling and negligible for those with 16 years or more. I may say here that this figure understates the proportion of the uneducated who are unemployed because they have a greater tendency than the better educated to withdraw from the labor market and not be listed as jobseekers.

The unemployed are the young—those without training, work skills or a foot in the labor force; teenage unemployment was 15 percent of jobseekers in this category last year and the Economic Report rightly calls this unemployment "the greatest test now confronting * * * our general economic and manpower policies." And the unemployed are the Negroes; Negro unemployment last year was more than twice that for whites.

The primary remedy for this unemployment is not to create demand, that is important, but rather it is better education, more job training, more deliberate job creation for youngsters and an equal break in education and employment for Negroes.

And, since we are dealing here with a seamless web, it means communities with better recreation, better welfare workers, better housing, better law enforcement, less squalid surroundings and an end to the Negro ghettos.

Tax reduction, which puts a few more spendable dollars in the pockets of the comparatively well to do, does nothing to make the unemployable more employable. And it also exposes the question of the quality of employment.

By sufficiently expanding demand, we can draw some semiliterate youngsters off the street and into jobs. Then official employment figures will look better. But this is something I would like to stress—they will be lousy jobs and those who hold them will be the first to be discharged when a machine comes along that can do the work better.

The test is not alone jobs but the preparation of people for high quality employment.

And not even employment is the only test of an economy. We want better communities and better services not alone because these insure more employable people but because they make life better.

The great economic anachronism of our time is that economic growth gives the Federal Government the revenues while, along with population increase, it gives the States and especially the cities the problems. The one unit of government gets the money.

The other gets the work. This adds to the danger that we will reduce Federal taxes at a time when States and especially localities are struggling with ever greater needs. It adds also to the urgency of Federal aid for specific local functions or a system, as Walter Heller has proposed, of providing general Federal assistance to local government. It argues against Federal tax reduction while local government struggles ever more desperately with the disparity between needs and revenues.

In short, there is a right way and a wrong way of attacking the problem of maintaining a high level of demand and an adequate rate of growth. The wrong way, which could become very popular with all who have a short-run orientation to their own pocketbook, is by tax reduction even though at the expense of needed public services. The right way is to provide for needed public services.

For many years now, economists have distinguished between a progressive fiscal policy that promoted economic expansion and an old-fashioned fiscal policy that balanced the budget and accepted the inevitability of recession and unemployment.

Liberals could be identified by their support of a progressive fiscal policy; conservatives were marked by their myopic insistence on a balanced budget. The distinction is no longer applicable. The need to sustain the level of demand is now common ground between men of widely varying political temperament and taste.

But demand can be maintained by reducing taxes and ignoring social need. This is reactional Keynesianism. Or it can be maintained by improving education, taking account of the problems of our cities and having compassionate regard for the needs of the less fortunate. This is the progressive policy. It will also be quite a bit more controversial. It has often been observed that economists, when they become noncontroversial, are usually either wrong or not doing anything.

I do not doubt that the President and his advisers are modern liberals. No President in recent times has put so many of our social needs on the agenda as President Johnson. I would hope, however, that the Congress, guided by this view of what is reactionary and what is progressive, will support and encourage the Executive in the proper course.

To meet social needs is the right course. To reduce taxes at the expense of social needs is the wrong course.

Chairman PATMAN. Thank you very much, Dr. Galbraith.

First I call on Senator Douglas to interrogate the witness.

Senator DOUGLAS. I would like to address a question to both of the witnesses whose testimony I think has been very good.

Banking groups justify increases in the short-term interest rate as necessary to prevent the flow of fluid capital, or deposit capital, abroad. I would like to ask first, what is your estimation of the probable amount, total amount, of this fluid capital which can be shifted from one area to another?

We had testimony from the incoming Under Secretary of the Treasury that the figure was somewhere between $500 million and a billion dollars and he seemed to agree that the most likely figure was somewhere around $600 million.

If this is true with a gross national product of over $600 billion, then this would amount to from one-tenth to one-sixth of 1 percent of the gross national product.

It would hardly seem worthwhile to depress the gross national product appreciably merely to prevent these fluid funds from going abroad.

I wonder if you have any answer to that question as to how big these fluid funds probably are?

Mr. HARRIS. Senator Douglas, one of the surprising things in the last few years has been the extent to which the short-term capital movements, the size of them—if you look at page 71 of the President's Economic Report you will find that short-term capital exports in 1961 were $1.4 billion; $700 million out 1962; 1963, $800 million out. The first three quarters of 1964, an annual rate of $2 billion.

These have been really surprisingly large figures. One can argue that all deposits might go out if people really were frightened of the dollar. I think it is the awful difficulty to know how much would go out.

I think it depends to a considerable extent upon foreign trade. For example, if you look at the bottom of page 71—I guess it is somewhere along here—they have a breakdown on page 76—they have a breakdown on what a large amount of this short-term capital is; 1964, third quarter, $372 million were back credits; $400 million were commercial credits; $308 million were liquid funds. I don't know what the Under Secretary was talking about.

I, myself, think I would disagree slightly with Professor Galbraith with whom I am generally in total agreement. We have not seen each other's papers or discussed our papers.

I would justify to some extent an increase in the short-term rate. I think we have done a wonderful job in having this increase in short-term rates and have kept long-term rates stable or even declining. I think the announcement by the President about the increase in rates, I think he made it quite clear, and Mr. Martin, I think, under pressure from the White House, that they did not expect this increase in rates to be transmitted to the domestic market.

I think my answer is not very good but I would say it is very difficult to estimate exactly how much more money would go out. The surprising thing is that there has been a large amount going out, much more than any economist expected, say, in 1960.

Senator DOUGLAS. The relative amount compared with the gross national product is very small?

Mr. HARRIS. Yes. I think this is the argument for putting the domestic economy above the balance of payments. I agree.

Senator DOUGLAS. I, too, think that it is really quite a performance to raise the short-term interest rate and keep the long-term interest rates approximately constant. But the margin between the two is almost nonexistent.

At one time, there was a difference of 1.1 or 1.2 percentage points. It is now only about one-sixth of a percentage point. The discrepancy between the two has largely disappeared. If you raise shorttime interest rates will that not lead inevitably to an increase now of longtime interest rates?

Mr. HARRIS. I would answer that by saying that if you increase the short-term rate, of course, people tend to take their capital and move into the long-term market. Of course, if the short-term rate is higher, then people tend to borrow from the long-term rate. Both on the supply-and-demand situation you get a reaction on the long-term rate.

I think the administration and the Federal Reserve have done a good job in dealing with that problem by taking special measures to bring the long-term rate down or keep it from rising.

I don't mean to say I agree with all the propaganda coming from the various parts of Washington that we need higher and higher rates. In fact I have been much against this.

Mr. GALBRAITH. You are not arguing for any increase in short-term rate now?

Mr. HARRIS. Certainly I am not.

Senator DOUGLAS. The second question is really more fundamental. I quite agree with you that De Gaulle's proposal would reduce the total supply of the international monetary medium from $65 to $40 billion by confining it entirely to gold. But the remaining $25 billion is almost entirely in the form of dollars. And dollars have to be redeemed in gold.

Does not this form an unsatisfactory type of international currency and does it not expose the nation which is the key currency to great hazards and dangers and isn't there a need therefore for not merely a new form of international liquidity but possibly a need for a new form of international currency?

Mr. HARRIS. Whom do you wish to answer that?

Mr. GALBRAITH. I think I would agree, yes. I think I should say one word on behalf of General de Gaulle. We should remind ourselves that great men do not have to know about economics and very rarely do. Mr. Roosevelt might have had a blind spot in this area. Certainly Churchill did. Mr. Churchill was the man who took England back to gold in the early twenties. It is interesting that the only time in his life when Churchill was respectable is when he was wrong in economics.

Senator DOUGLAS. You could have said it was the greatest mistake he made.

Mr. GALBRAITH. It was much applauded at that time by many reputable people in Europe. I myself think there are large elements of romance in General de Gaulle's proposal and it is not quite as well thought out or even as strongly intended as Professor Harris suggests.

Now we need greater international liquidity. Either in the form in which you suggest, sir, or some other form. But we need to bear in mind this is something we can only bargain for when our own balance of payments is in reasonably good shape.

It is not something on which we can persuade the Common Market countries to go along with us on when we are bargaining from a position of weakness. This has been one of the shortcomings of the past suggestions. They have been economically sound but they have not taken full account of the weak political position of the United States as a bargaining agent as long as we are worried about our own balance of payments.

I would like to think of this as something we do just as soon as our balance of payments is in reasonably good shape and as a precaution against the next difficulty.

Senator DOUGLAS. Would you regard an increase in the funds of the International Monetary Fund as giving to other countries an easy way out for increasing liquidity?

Mr. GALBRAITH. No, I think this is a milder step. I would not exclude that. I was addressing myself, as I thought you were, to the much larger proposals such as those which have been advanced by Professor Triffin and others.

Senator DOUGLAS. Mr. Harris, do you have any comment?

Mr. HARRIS. I am inclined to agree with Professor Galbraith. You may recall, I am sure Congressman Reuss will recall, that in 1962 and 1963 there was considerable discussion in the administration as to whether we ought to really take advance moves in this direction.

There was a good deal of criticism of the Treasury for moving rather slowly. I think the way the thing developed, when you think what happened in 1963 and 1964, it is clear that although we may not have been moving fast enough in this area of increasing international liquidity, our position was weak.

What happened was that we became extreme in this matter. We wanted much more expansion of liquidity than any of the European countries would give us.

So we looked like the heroes in this dispute where earlier it seemed as though we were the ones holding up progress in this area. I agree with the general point of view you are making. There is a certain amount of danger of people getting more and more dollars as a result of our deficits and finally they are in a position to threaten our whole reserve position.

Chairman PATMAN. Mr. Ellsworth.

Representative ELLSWORTH. Thank you, Mr. Chairman. I am sorry I did not get here for Mr. Harris' statement but I have a copy of it and I will study it. I would like to address a question or two to Mr. Galbraith, for whom I have always had a great deal of admiration, his writings and activity in government, although I do not always agree with his ideas.

Professor Galbraith, you make a very important point that economic growth gives the Federal Government the revenues and the cities and States the problems.

Then you discuss that for awhile. You touch on Professor Heller's idea of unrestricted grants to the States which I want to come back to and ask you about and you go on and say there is a right way and wrong way of attacking the problem of maintaining a high level of demand and adequate growth rate.

You say: The wrong way is by tax reduction. The right way is to provide for needed public service.

Now when the gentleman from Arkansas, Congressman Mills, presented the tax bill in 1964 he led off the debate by saying we could pursue one of two policies: either the policy of increased expenditures for public works, or the policy of tax cuts accompanied by expenditure control and said he was urging the second approach.

It was on that basis that the administration tax bill was presented to the House. Furthermore, the other day when the Chairman of the Council of Economic Advisers was before this committee, speaking of the prospects for 1965, he said in his statement:

> The prospects for further gains in 1965 are much improved by fiscal programs that will be reinforcing rather than restraining the strength of private demand.

Now I would like to ask if you want your statement this morning to be understood as being critical of the administration's approach to the tax cut of 1964, of the Council of Economic Advisers' approach to the prospects for 1965 and of the administration's proposed excise tax cut for 1965?

Mr. GALBRAITH. I don't think I am violating any executive privilege when I say there were long debates at the time in the Kennedy administration on this issue.

I was never as enthusiastic about the tax reduction as some of my colleagues, as I say in my statement. I do feel, Congressman, that there was probably a case for the 1964 cut based on the fact that the tax yield, under conditions of very high income, got very large and, therefore, exerted a very strong drag. So that the step to take, one corrective cut, had something to recommend it.

My concern at that time, and my concern still, is that having done this, and as an isolated case, we may find it too easy to keep on doing it and that it will attract to the fold of Keynesian economics some extremely improbable recruits.

This is going to make all my Keynesian friends quite uncomfortable.

Now as to the excise taxes. I don't want to seem to be critical, these could be argued both ways. These were taxes put on during World War II.

They were temporary. Possibly as a measure for repairing the tax structure these rather arbitrary taxes should be now taken off. It can be argued both ways. I am not critical of the Administration and Council of Economic Advisers. However, my emphasis on these matters, I must say, is somewhat different from theirs.

Representative ELLSWORTH. It may not be that you have any views on this but would you like to comment on this proposal for block or unrestricted grants out of the revenues that the Federal Government takes in back to the States?

Mr. GALBRAITH. Or localities?

Representative ELLSWORTH. And, or localities.

Mr. GALBRAITH. I must say that I am attracted by it, Mr. Ellsworth. The argument against it is that not all of the States have the standards of impeccable honesty that we have become accustomed to in Massachusetts and that some State governments would waste the money, as would some localities. [Laughter.]

In part, the quality of State governments and the quality of city governments is related to the past starvation. If one has reasonably adequate budgets one can hire reasonably good people. They don't have to supplement their income by various forms of minor larceny and you have better administration.

One of the reasons that the Federal administration is better than that of many of the States is that Federal employees over a long period of time have been better paid out of the more nearly adequate revenues of the Federal Government.

It is not because honest men gravitate to Washington and leave the crooks or the incompetents behind. So, I am not terribly impressed by this argument. On the other hand there is a great deal to be said for continuing the more conservative policy of supplementing particular activities and using the leverage that comes from holding the money to seek to improve standards. On balance, I think I would come out on the side of a modest step in the direction of Heller's proposals.

Representative ELLSWORTH. Thank you very much.

In conclusion, Mr. Chairman, may I express appreciation to Mr. Galbraith for his reference to the Kansas schoolteacher.

Chairman Patman. Mr. Reuss.

Representative Reuss. Thank you, Mr. Chairman.

I, too, have tremendously enjoyed this presentation this morning.

Mr. Harris would like to bring unemployment down to 3 percent if he can and suggests that the way to do it is by an adequate fiscal policy, some mix of tax reductions and expenditures increase. I take it that is what you mean by that. What about you, Mr. Galbraith?

In your fascinating book, "The Affluent Society," some years ago, talking about no particular period in time you urged less emphasis on a job as a key to sharing in the fruits of production.

However, you are here today testifying about 1965 and the years immediately ahead. Do you share Mr. Harris' view that we should continue our goal of bringing unemployment down to around 3 percent?

If your answer to that is that you do I'll wait until I hear it from you—then what methods do you advocate directed toward that end?

Mr. Galbraith. Yes, I would urge getting the unemployment rate down. It is an established test and I think it is a good one. In "The Affluent Society" I argued that a comparatively well-to-do society could afford to provide generous alternatives to employment for a man who could not get a job.

As to the strategy, I see it as overwhelmingly concerned with the profile of the unemployed.

The unemployment is very high among those with little education and it is negligible among those with 16 or 18 years of school. It is very high among youth. It is much lower among established jobholders. There is the special problem of Negro unemployment. I am very much persuaded that the central strategy of unemployment is to make these people not only employable but employable in much better jobs than they will get if they are merely dragged on to a payroll by general fiscal measures.

Therefore, I see the sort of things that are being done in the proposed education bill and the measures which are now going into effect upon the poverty program as well as the training programs of the Department of Labor—this whole panoply of measures as being now the central part of our unemployment strategy—as our strategy for attacking unemployment.

Representative Reuss. Without differing from you in any way in your emphasis on education and other ad hoc structural methods of dealing with unemployment, what do you have to say about the fact, and I believe it is a fact, that in this last year, and I think largely as a result of the tax cut, while unemployment generally has been cut some, perhaps half a percentage point, that the biggest beneficiaries of reduced unemployment have been the disadvantaged groups, the blue-collar people, the young, and the Negroes, whose unemployment I believe has gone down about twice as much percentagewise as the overall average?

Doesn't this suggest that we need to work on both the demand and the structural attack on unemployment?

Mr. Galbraith. That is right; yes, sir. I don't exclude the need to keep the pressure of demand on the economy by any means. I am only urging that this is no longer the primary part of the strategy. I also would point out that the statistics here can be misleading and are. It is true that blue-collar and Negro employment has improved most in the past year. On the other hand, this is the place where the people were available to be employed.

It remains true that unemployment in these categories is still vastly above what it is among educated people.

Mr. HARRIS. Could I make a comment?

Representative REUSS. Yes.

Mr. HARRIS. I think the one point where I disagree with my friend and colleague, Kenneth Galbraith, is on the issues of the virtues of the demand approach as against the structural employment approach, and I think Mr. Myrdal presented Galbraith's position—or vice versa—effectively, but I think he was wrong.

The thing Galbraith seems to forget is the maximum of additional jobs you can get is determined by the number of unfilled vacancies you have. When you have a large amount of unemployment you don't have too many unfilled vacancies. I am all for the program that Senator Douglas and others have introduced. I am a member of the advisory committee of the area redevelopment program. I think enough money has not been appropriated for these purposes and we ought to appropriate more money.

I still think the major factor is demand—Galbraith is always looking for new worlds to conquer—he has had 15 or 20 years of Keynesian economics. He tends to throw it out of the way and move on to new worlds. I once went through all Keynes' writings. I found two places where he mentioned a tax cut as an approach to the problem of unemployment.

The explanation of that is that Keynes at that time thought that taxes were not very important. If he were alive in the late forties or fifties I am sure he would have gone to tax cuts as well as spending. I would emphasize more than Kenneth Galbraith does the demand approach. I think on the whole I would be a little more in favor of tax cuts than he would, but as far as the general picture goes, of course, we are in agreement.

Representative REUSS. I am glad you have cited some disagreement. Let me try another.

On the monetary policy, Galbraith has said that he disagrees with the raising of rediscount rate by the Federal Reserve last November. Would you care to express yourself on that?

Mr. HARRIS. I think there was some justification. I think it was done in a very effective way. I think it was done in such a way that it was not transmitted to the whole economy. I think that President Johnson and Mr. Martin made it clear that they didn't expect this to affect the whole economy. I am sure it did have some effect.

Representative REUSS. Then what was the point of it?

Mr. HARRIS. The British raised their rates by 2 percent; what is a half-percent increase going to do here? I think the theory was not so much that the British were trying to make things more uncomfortable for the British, but that they were trying to stem the tendency for dollars to move to the foreign markets on the Continent. I don't know that it had any great effect.

I think the fact that it was soft-pedaled by the administration and Mr. Martin tended to reduce the effect. I don't think it was a terribly important issue. I was for it as long as it did not have any serious effect on our expansionist policy, and I don't think it did.

Representative REUSS. If it was soft-pedaled, as I guess it was, wasn't the principal effect to give the American banking community the best of both worlds; that is to say, raising the rediscount rate tends to raise the interest charges that banks get on their loans; equally, the soft pedaling, by creating additional reserves, kept up the volume of loans, so that the banking community was the real beneficiary of something that gave them a high price and a large volume.

Mr. HARRIS. I think it had a small effect, Congressman, on the rate in the private, short-term market. It did have some effect there. I think it has had a small effect. As you know, I have always felt that the finance people want higher rates than they should get.

I think, as Professor Galbraith so well said, everybody likes higher prices. My point is that the financial people don't always distinguish between their interest and the interest of society. Sometimes you can do much better when you can sell a large quantity of products at a lower price.

Mr. GALBRAITH. I must say that I was completely puzzled then and I am still completely puzzled by this action. I would go back to my original statement, which is, I think, the automatic reaction to any excuse to raise rates. It has happened before and doubtless it will happen again. The British were in great trouble. There was a great run on sterling. They were trying to correct that action. We presumably wanted to help them in it and indeed we raised the fund of around $3 billion to help them.

At the same time, however, we worked against that action by raising our rates in order to hold—presumably in order to hold—funds here. The logic of this is impenetrable.

Mr. HARRIS. There is one point I mentioned before, the British raised the rates by 2 percent, we raised ours by ½ percent. There was no disposition to believe that this would improve our position vis-a-vis the British-American situation.

Mr. GALBRAITH. Certainly the British thought so.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I am delighted to see both of these eminent economists come down on the side of not increasing interest rates. The lead story in the Wall Street Journal suggests we are moving toward tighter money. I would like to have your comments on whether or not you think this is serious enough for us to be concerned about it.

The headline is "Bankers quietly begin raising loan charges on a selective basis. Fewer borrowers now get 4½ percent prime rate." The body of the article says:

> In essence they are keeping a 4½-percent prime rate on their books but granting it to fewer borrowers, charging other borrowers a greater premium over the prime rate.

It says:

> First-loan demand has picked up enough now to make it much more likely higher interest charges will stick. So far in 1965, January 1 through February 17, commercial and industrial loans by major New York City banks rose $348 million, to a total of $14.2 billion. In the corresponding period of 1964, the loans fell to a total of $12.2 billion.

It seems on the basis of the present economic facts of life that maybe this avoidance of the President's very strong plea and specific plea to maintain the prime rate of 4½ percent is really pushing up rates and likely to arrest economic growth. What is your reaction, Professor Harris?

Mr. HARRIS. Senator, you probably have more drag with the Federal Reserve than I do, and you probably know what they are thinking.

Senator PROXMIRE. I doubt very much if I have more drag than anybody with the Federal Reserve.

Mr. HARRIS. I think there probably is, at the present time, some danger of a hardening of rates. I think that with the great amount of unemployment at the present time we should be against any further hardening of rates.

I notice also in the newspaper—I think I saw this this morning; I think it was in the New York Times—that the Federal Reserve is buying some long-term securities, which suggests that perhaps they were trying to offset any attempt on the part of the private market to raise their charges by making more money available through the purchase of long-term securities. How large these purchases were, I don't know. There was a statement to the effect that there were large increases in purchases by the Federal Reserve.

Senator PROXMIRE. Then your answer is that there is nothing here that the Federal Reserve can't handle easily by their policies?

Mr. HARRIS. My guess is that certain members of the Federal Reserve, I think—including Mr. Martin from his statement made recently—are concerned, and they are worried that the situation may get out of hand. I don't think some of them would be very unhappy about a further increase in rates. I, myself, have some doubts about whether this is desirable.

I think as long as our income is rising $30 billion to $40 billion a year with a large amount of unemployment and prices being surprisingly stable, we ought to be careful about any increase in rates. If the private market is trying to take advantage of this situation, the Federal Reserve ought to set it back.

Senator PROXMIRE. The only argument I have heard for a raise in interest rates is the balance-of-payments argument. The Wall Street Journal has another interesting chart here, lending rates, United States lowest at 4½ percent. Then Switzerland higher, Netherlands, Canada, Japan, and so forth. These are short-term lending rates. It is again the argument that we have to be competitive and, of course, we are going to lose capital if our terms are less desirable.

It is difficult for me to understand why, if short-term money is interest-rate sensitive, if it is, why we don't apply the interest equalization tax to it? Less than 1-year money is excluded, as you know. It is true that they say it is harder to administer, and it is true that it is necessary to finance trade, but if it is necessary to finance trade, then it should not be really interest-rate sensitive.

There have been no studies, the studies by Bell and others have indicated the contrary: that the short-term money is not interest-rate sensitive.

Mr. HARRIS. As you know, the Kenen study showed the opposite. Bell and Kenen came to opposite conclusions on this. We don't know as a result of these two studies what the real situation is.

Mr. GALBRAITH. May I say a word on this? I think we always need to keep in mind here not the concern with single measures, but with the strategy. We have long recognized that the interest rate policy followed by the Federal Reserve can put more or less pressure on fiscal policy. If one has a high rate of interest and some cutback as a result of domestic investment then a bigger load will have to be carried by the deficit if one is going to continue to have a full employment policy.

One of the great reasons for insisting on low interest rates for the central bank is that it takes some of the burden off the budget. One can come closer to a balanced budget and one has more freedom and flexibility in the things that one uses budget funds for. The same interconnection exists as regards the strategy with the balance of payments. If I had substantial quantities of money to lend, or wanted to have the kind of reputation in the financial community for always saying agreeable things that I somehow have escaped over the years, I would be strongly in favor of using the interest rate as a balance-of-payments measure.

This has the effect, as Professor Harris has said, of shifting the balance of income in favor of those with money to lend and I don't think that there has ever been any indication, as I said in my earlier remarks, that people with money to lend are more indifferent to the income it earns than are dairy farmers to the price of milk.

If I were looking for a balanced economic policy in a country with large savings, I would be much more inclined to argue for some restraints on long-term capital outflows. What does this do? This tends to hold capital funds here in the United States. It tends to depress interest rates. It tends to encourage domestic investment. It tends to put the economic policy of the United States ahead of the simpler question of earnings on capital.

I think the strongest part of the case for restraint on long-term capital output is that it enables us to manage the balance-of-payments problem in a fashion which is consistent with domestic welfare and sound domestic economic policy.

Senator PROXMIRE. You suggest we might restrain long-term money going abroad; is that right?

Mr. GALBRAITH. That is right.

Senator PROXMIRE. If we do that, it would seem to me we interfere with kind of a private, disciplined foreign aid program which has the effect to some extent at least of building up the economies of free countries throughout the world and does so in a pretty disciplined way so that the money is invested where it will bring a good return and where it will do some good.

Mr. GALBRAITH. Consistent with the courtesies of the occasion, I must persuade you to the contrary. The argument has no merit whatever. This capital is not going to India.

Senator PROXMIRE. I know that, of course. It is going to Canada and to Europe.

Mr. GALBRAITH. It is going to countries that are only marginally less developed than ours. This is where the overwhelming proportion of it is going, and it is going to go to countries which have rich capital resources of their own, so that we can make a case that we are building up competitors. We can make a case that we are helping people who are almost as well off as we are. But we cannot make a case that we are engaged in any form of economic development of the countries that really need it. The enthusiasm of American investors for India, for example, is very restrained.

Senator PROXMIRE. I understand that. This kind of money is not going to South America. It is not going to India and other undeveloped countries, but at the same time it is going to countries which are free countries and whose economies are being advanced by it.

Also, the restraints you favor are an interference of a degree, with freedom of the people to invest their money as they would like to invest it. At any rate, your argument is that what we should do is restrain long-term investment and not short-term investment and restrain it perhaps by law and not ask voluntary cooperation.

Mr. GALBRAITH. That is right. I would point out, too, that this is an area which is replete with restraints of one sort or another. We are the only country with the possible exception of West Germany which does not have some mechanism of restraint now. One becomes uneasy when one hears about the arguments of the free market here.

Is a market controlled in very substantial measure by the Open Market Committee of the Federal Reserve a free market, or is it a rigged market, if I may use a rather unfortunate term? Obviously it is a controlled market. We are making our way here through an area which is replete with price fixing, replete with controls. I don't think we can be terribly concerned about the fact that we are adding any further restrictions on the free market.

Mr. HARRIS. May I make a point there, Senator?

Senator PROXMIRE. Yes. But first, I would like to say that there is restriction now within the framework which the Open Market Committee has established and within which money can then be invested wherever the investor feels that he has the best opportunity for a good return. Now, you have to have additional restrictions if you are going to keep this from going to developed countries and try to encourage it to go to less developed countries.

Mr. HARRIS. Senator, you started off by asking about this short-term increase in the rate of interest. I think right now we are at a point where the financial people realize that this is going to be a struggle between whether you control the situation by a rise in the rate of interest or whether the capital issues are controlled.

This is all intuition so far as I am concerned. My feeling is that this is a very crucial period; that the voluntary program is only going to work for the banks for exports, more for corporate loans. We are going to have to resort to a capital issues program.

What the finance people are trying to head off is that kind of approach. They like the approach of the higher interest rates. My guess is that this is the problem.

On the point of capital issues, I think one has to realize that there is something awfully bad about this program of exporting our capital to Western Europe in large quantities. As Professor Galbraith said, there are important political issues here, getting control of a large part of the German, French, Italian markets with our industries. I understand from somebody in a position to know that the Germans are beginning to rebel against this excessive exportation of capital taking over their industries.

There is a lot to be said about the discouragement of this kind of economic imperialism on the part of American corporations.

Senator PROXMIRE. Thank you.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. I apologize for being late.

As I recall, Mr. Galbraith, at one point during the tax cut consideration you pointed out that it would be of more value to extend unemployment compensation. Do you now feel that?

Mr. GALBRAITH. Yes, I think we could certainly be more generous than we are in our unemployment compensation, certainly in some of the States.

Representative GRIFFITHS. How long would you extend that?

Mr. GALBRAITH. Of course, we have great differences between the States now. I confess that I would be most concerned with seeing steps taken to bring the poorer States up to the level of the States like yours which treat the unemployed man somewhat more satisfactorily.

Representative GRIFFITHS. Well, we are pretty bad.

Mr. GALBRAITH. What do you have?

Representative GRIFFITHS. At least during the time I was in the legislature, we had a sudden death clause in ours that was not available in anybody else's. We were indeed the worst. We may have paid, but we paid under very limited circumstances.

Mr. GALBRAITH. I stand corrected. I thought the Michigan system was pretty good.

Representative GRIFFITHS. Well, it isn't.

Would you suggest that the money come back out of the Federal Government for this extension of unemployment compensation and not be charged off to the higher wages at all?

Mr. GALBRAITH. You mean whether we should have a permanent system of supplementary?

Representative GRIFFITHS. Yes.

Mr. GALBRAITH. Yes, I think I would be inclined to say we should.

Representative GRIFFITHS. Would you assume that an extended unemployment period would tend to raise wages otherwise?

Mr. GALBRAITH. If a person has anything which gives a man alternatives, has some stiffening effect on the wage rates, I don't think that this is at all unfortunate. I would suppose, yes, that over the years, one of the effects of social security has been to firm up wage rates.

Representative GRIFFITHS. Would you say that it would also have some tendency to raise prices?

Mr. GALBRAITH. Possibly where they need to be raised, yes . Again, one of the reasons that we have less problems of sweatshop labor than we had 30 or 40 years ago is that we have fewer people impelled to take those jobs because of destitution. This means that in the industries that flourished on that—the clothing trades, the vegetable growers, industries which were scavengers on the edge of the labor market—this labor was not as available.

Representative GRIFFITHS. As it tended to raise prices, do you think it would have any effect on our balance-of-payments problem?

Mr. GALBRAITH. No, not appreciably; not perceptibly, no.

Representative GRIFFITHS. You do not then agree that the reason that we have increased our sales abroad is because of stable prices? Do you think there are other reasons?

Mr. GALBRAITH. The difference here is that this would be a very marginal—almost invisible—effect on prices, whereas, the main reason for our price stability in recent years has been that we have managed to keep the large wage movements associated with collective bargaining contracts fairly well within the productivity gains, fairly well within the guideposts. This has eliminated the wage-push pressure on prices.

We have done a much better job in this area than have the Europeans. This has been the reason for our comparative price stability, the biggest reason in my view; whereas, the Italians, the French, and even the Germans have not done nearly as well in this regard. There have been other historical factors.

In the early years immediately following the war the Germans—to some extent the French, also—were taking advantage of big productivity gains which grew out of new plants and the new capital equipment that they had at that time. They have run out of these productivity gains to some extent, so that their wage pressures hit much more directly on prices than they did 8 or 10 years ago.

Representative GRIFFITHS. The undisputed testimony before the Ways and Means Committee is that if hospital employees' wages were raised throughout the country to the minimum wage that it would add $2 billion annually to the hospital bills in this country.

Chairman PATMAN. Mrs. Griffiths, would it be asking too much of you to ask you to yield to me a moment?

I have to go to the floor on a very important matter. I will just take my time now if it is all right.

Representative GRIFFITHS. Certainly.

Chairman PATMAN. I want to ask the gentlemen about the gold question, which should be an easy question for them to answer.

The United States is the only nation that will deliver gold to central banks on demand, as you gentlemen know. Now I fail to see why we should be the only nation that does this. It was all right when the European nations were in a stage of rehabilitation after the war, but now that they are apparently recovered and, indeed, are taking our gold, I am wondering whether it is not time for a change in our gold policy.

Will you comment on this? And I would like to add one further consideration. France is demanding gold from us on a large scale.

Under the circumstances, I personally think it is just unfair and ungrateful, we being the only nation in the world that is paying gold. None of the others are paying gold, on demand, from a central bank or anywhere else.

Inasmuch as France is demanding gold, do you think that some consideration should be given to reducing or eliminating our military expenditures in France which aggregate about $200 or $300 million a year?

Of course, we would not want to do anything to interfere with our NATO commitments or anything else but we could, I believe, lower the amount of our expenditures in France without doing that.

Would you gentlemen comment on that, please?

Mr. HARRIS. As you probably know, Congressman, the surplus of the French nation is roughly about $500 million a year according to the best estimates we have. That means they might conceivably convert $500 million per year. I think there was a discussion between Senator Douglas and some witness here in which it was also pointed out that we need about $500 million additional gold reserves in the United States to take care of the growth in the amount of cash.

So there you have a billion dollars of gold required. I think it has been rumored for years that the French have been blackmailing us because they have a billion and a half in dollars. Not only do they tend to convert their $500 million of deficits but, also, use up some of their capital in dollars increasingly as the dollar is in greater and greater difficulties, and encouraging other countries to do likewise.

Certainly the Dutch and Belgians follow a French pattern. I think there is an awfully strong case for the French taking care of their own military requirements; but this is a matter of diplomacy. You are right that the United States is the only country that pays out gold. If anybody has pounds and wants gold they have to get it via the United States.

The British won't pay out gold for the pounds. It is most unfair. I have always had the theory, I don't know whether my distinguished colleague agrees, when we go over and bargain with the Europeans we always get a bad bargain. We are not as smart as they are.

This has been my general impression over the years. I think the case in point is the one that Professor Galbraith just mentioned, that most European countries have a ban on capital. We announce we are going to try to do something about capital movements and they are upset and say it is not the right thing to do.

Chairman PATMAN. They want us to raise our interest rates.

Mr. HARRIS. That is it exactly.

Chairman PATMAN. Dr. Galbraith, would you like to comment, please?

Mr. GALBRAITH. I might read a sentence or two from an article that I published on this subject last spring.

The relevant paragraph is as follows:

> In the past our force commitments to France and Germany has poured dollars into these countries and by weakening our balance of payments, weakened our bargaining position vis-a-vis these countries. Military commitment has then been defended on the grounds that it is necessary to our position in Europe.
>
> The flaws in this logic suggest the need for a more reflective view of the issue. Deployment must be reexamined from modern technical development in transport and long-range fighter aircraft. These now give the option of deploying troops so as to minimize foreign exchange cost without lessening their real as distinguished from their symbolic effectiveness.

There is no doubt that I am in substantial agreement with you.

Speaking not as an economist, but as a modestly informed observer I believe that one of the important steps that we could take would be to see whether in this age of modern air transport we need to station physically as many troops in either Germany or France as we do, whether aircraft have not given us the option now of having a division in Maryland or in Virginia or elsewhere and rotating it through forward installations from time to time.

This particular matter has been talked about within the administration in the past, and I would hope that there would continue to be discussion of this possibility.

Chairman PATMAN. Thank you very much.

Mrs. Griffiths, thank you, ma'am, and will you please resume your questioning? Senator Douglas will preside.

Representative GRIFFITHS. Thank you very much.

I would like to comment on Mr. Harris' remarks. Here I understand you to say that you felt that at the bargaining table in Europe that we get the worst end of the table because in this we are not as smart as they are.

Mr. HARRIS. Yes; I do. I taught international trade for 40 years so I watched this situation. In the Common Market a job is being done on us. I feel this is absolutely true. I think we have improved some in recent years as negotiators but I think we are not doing as well as the Europeans are.

Representative GRIFFITHS. I think the big problem we have in this country is that we still look at Europe as the model. We believe they are smarter than we are. We are convinced that what they have is correct.

All you have to do is look at the billion dollars worth of gold in the Schoenbrun Palace and come back to America and look at the system we have created where the things that we have are the things that would have been available only to kings.

I think it is time for us to quit looking to Europe and start looking at ourselves. I am sure that in reality we have done it better. The things that they have for a restricted few people we have given to everybody.

Now back to Mr. Galbraith. While I personally have the feeling that all of these things would be a push upon the wage structure of this country and I have no objection to the fact that we raise the wages. I hope that we also have some chance of seeing to it that the wages of other areas of the world are raised, also, so that our goods are not made less competitive.

Mr. GALBRAITH. I think I would agree with you on that. I don't think I would entirely agree with my colleague that we are always bested in international negotiations.

Mr. HARRIS. Not when you the leading it; I did not mean that.

Mr. GALBRAITH. I have the feeling that we rarely bring to bear in international negotiations the political bargaining skill that we take for granted here in the United States. I used to tell President Kennedy that he never had any hesitation about my ability to deal with Prime Minister Nehru who was one of the most intelligent and subtle, intricate and able politicians of the 20th century. But he would not dream of entrusting a political problem in South Boston, Mass., to me. He would take it for granted that Boston politics were far beyond my comprehension. And quite rightly, no doubt.

Now we send people to do business with Nasser who would not for a moment be entrusted to bargain with Mayor Daley. I don't think that we have brought in this field the actual resources of political skill and the full instinct of political negotiations that we have available.

Still I am not certain that we do quite as badly as Professor Harris implies.

Representative GRIFFITHS. May I say that I hope that someday we have a common market of the Americas and invest this money here where it will help.

What in your opinion would be the greatest difficulties? Forget about wheat. I think we can have a wheat pool.

Mr. GALBRAITH. One problem we face is the very uneven rate of development in the Americas. The Common Market in Europe is forged between countries of roughly comparable levels of development.

The problem we face here is that we have one highly developed country in the United States, one moderately developed one in the case of Canada, and other countries which are just on the threshold of the industrial age. There is no question, there should be no question in anybody's mind, that tariffs, restrictions on imports, are useful things for countries that are in the very first stages of industrialization. This means that the common market in this hemisphere would be almost inevitably biased in our favor. We might as a result have considerable difficulty in persuading the lesser developed countries that they should go along with us on it.

They might have various good reasons for their not doing so.

Representative GRIFFITHS. Capital is one of the things they need and leadership among the various industries so that if we could go in and give them that it would be a vast help.

Mr. GALBRAITH. I think that is true.

Mr. HARRIS. May I make a comment on your point about the payroll tax?

Representative GRIFFITHS. Yes.

Mr. HARRIS. This is a subject to which I devoted many hundreds of pages at one time in my career. The general theory is that if you increase the benefits financed by payroll taxes on employers, the employer cuts wages correspondingly.

There is some exception to that in certain circumstances. Senator Douglas might have some ideas in this area.

Senator DOUGLAS. I think that is substantially true; yes.

Mr. HARRIS. If the benefits are financed out of governmental deficits it might conceivably have some effect on prices in a period of high employment.

Senator DOUGLAS (presiding). Mr. Reuss.

Representative REUSS. To raise a subject which was not commented on in your papers but in which I am interested, one hears it said nowadays in connection with a minimum wage that particularly if the minimum wage were extended to groups not presently included and particularly if it were raised to, say, $2, that this might at some point have the effect of denying simple people simple jobs. While I personally have been most sympathetic to the idea of the statutory minimum wage, I can see some point at which these considerations need to be taken into account.

I would be interested in what you gentlemen think about it.

Mr. GALBRAITH. I would be in favor of going to the $2 minimum wage. I would also be in favor of a further cut in the work week. I think both of the proposals now being made by the combined labor movements are right. It is possible that, as was done, for example, some years ago, in the case of Puerto Rico, that this should involve consideration of the exemption of occupations or areas, some review of that, to make sure that the effects that you mention are not too severe at once. But I would say that the lesson of the minimum wage legislation is that the people who feared that this would take people out of jobs is wrong and that the effect of it in raising up the standards of competition of the labor force has fully justified the measure and that we should press forward to rates that are approximately a living wage.

Mr. HARRIS. If I may make a point there, Congressman, when I was advising New England Governors, we used to seek higher minimum wages because we wanted the wages to go up in the South. They were taking away our jobs and we thought this was a good way for New England to maintain its share of the jobs. That is a special reason for high minimum wages.

There have been a number of studies made when earlier increases were made. On the whole these studies did not show there was any serious effect on jobs. If you get up to $2 there may be some problems here.

I think, perhaps—helping Galbraith out—what he would say would be that if people lose jobs then we have to find other ways of taking care of them. Otherwise I think if you get the minimum wage up, particularly if you have large amounts of unemployment, I think you may very well find many who cannot produce $2 per hour.

If you have an excess of jobs rather than of men that is the time when you really get minimum wages up without any serious effects for the time being.

Representative REUSS. Thank you.

Senator PROXMIRE. Yesterday Dr. Kermit Gordon, Director of the Budget, testified.

The New York Times had a very clear and very excellent article with the headline, "Net stimulus to economy provided in the budget is put at $2 billion."

I discussed with the reporter, who is certainly a competent economist, the testimony of Dr. Gordon. I am still confused. I have talked to some competent economists since then and they tend to agree with me. I would like to ask your conclusions. The budget document [1] on page 12, this is the booklet I am referring to, points out that the cash budget—not the administrative budget, but the cash budget—shows a deficit, an estimated deficit in fiscal 1966 of $3.9 billion.

This is a hundred million dollars less than the deficit, the cash deficit in 1965. The national incomes deficit in 1966 will be $6 billion, an increase of $1 billion in the deficit.

Now my question is, Why does not the national income budget or the cash budget, whichever you prefer, roughly indicate the stimulus to the economy of the budget? I thought that was the whole purpose of devising the national income accounts budget, and one of the very useful aspects of the cash budget. The deficit measures the difference between the expenditures on one hand and revenues on the other for the entire year, the estimate.

Mr. HARRIS. I read that piece in the New York Times, too. I was puzzled by it.

Senator PROXMIRE. I feel much better.

Mr. HARRIS. I think the explanation partly is that Gordon was talking about 1965 calendar year when he was talking about the net stimulative effect.

[1] The Budget in Brief, Fiscal Year 1966.

Senator PROXMIRE. Mr. Dale agrees with it. I discussed with another economist this notion of the calendar year difference. If you consider this you have to take the 1965 and 1966 estimates and strike an average. If you do that you come down to the cash budget of 4.0 in 1965 and 3.9 in 1966, which would mean you would have about the same stimulus. With the national income accounts it is 5.0 in 1965 and 6.0 in 1966, or for calendar 1965 you would have 5.5.

Mr. HARRIS. By taking the cash deficit you do get a very effective measure of the stimulative effect. The way I interpret the $2 billion, I may be wrong, but you have a $5 billion stimulus through a reduction of taxes and $3 billion through a rise of expenditures, which means an $8 billion stimulation. Gordon said we have a full employment surplus of $6 billion. I took the $8 billion and deducted the $6 billion. That gives you the $2 billion net stimulation.

Senator PROXMIRE. That is what Kermit Gordon did and what Mr. Dale reported. I don't understand why that measures the stimulus. It seems to me that this estimate perforce has to assume what the increase in revenues is going to be during the next year. We are not going to have full employment. We are going to be short of full employment; we know that. At least that is the estimate.

Under those circumstances, it seems to me that if this estimate is an honest estimate that it should reflect the best judgment of the Budget Bureau as to the stimulating effect of the——

Mr. HARRIS. Isn't what the Budget Director really saying is that this is what we, the Government, are going to do? This is the $5 billion and the $3 billion. An increase of operations and a reduction in taxes. Now, what the cash picture shows you is the total picture of what is happening, including past commitments and all that sort of thing.

At any rate, the point is, on a cash basis you only have a $4 billion stimulus. I, therefore, argued I was not sure that was enough. In other words, the cash plus and minus is a broader study of the whole problem. It takes into account the whole general picture. What the Gordon estimate was, this is what he was really saying, this is what we are doing now to stimulate the economy. When you are all through looking at the whole picture, you have a $2 billion difference between receipts and expenditures, allowing for the adverse effect of the $6 billion surplus at full employment.

Mr. GALBRAITH. I confess I haven't done my homework. I don't think I have anything to add to it.

Senator PROXMIRE. Let me ask Dr. Galbraith one question. You say:

> The guideposts on wages and prices are central to the defense of the dollar. And they are important for domestic tranquillity and our reputation for good economic management. Adherence to these guideposts is overwhelmingly the reason for the stable prices of these last years.

I am wondering how you arrived at the notion that the guideposts have been adhered to consciously? We read so many stories, you may be correct, and I hope you are, but we read so many stories about the unions who say they are not going to pay any attention to guideposts, that they are wrong in principle, and certainly many union and business leaders feel that way.

We have had some stability, but I am wondering if the guideposts played this direct and explicit part.

Mr. GALBRAITH. This would be my view. This is the kind of issue where there can be differences of opinion. It is true that wage increases, generally speaking, in the economy in these last years have been well within productivity gains. At least since the interchange between President Kennedy and the United States Steel Corp. there has not been strong pressure by the corporations to go beyond their present price levels.

By contrast, in the 1950's one had wage increases, the Eisenhower administration stood down on this, said it was not interfering, made generalized pleas for restraint, but declined to set specific standards. Wage increases during those years ran ahead of productivity gains.

There were corresponding price increases more than necessary to cover the wage increases, and during that period, particularly during the later part of the 1950's, generally speaking, unemployment was not lower than now. We had persistent creeping inflation. This would be the reason for my attributing the recent stability to the setting of these standards and to the fact that for one reason or another both the unions and the corporations have stayed within them.

Senator PROXMIRE. Do you know of any studies that have indicated that the companies, for example, that have no improvement in productivity have increased their prices just modestly to reflect this fact; that those that have an average increase in productivity have maintained stable prices; and those who have had more than average increases in productivity have reduced their prices? Is there any conscious pricing policy at work here or are there other factors affecting prices?

Mr. GALBRAITH. The Eckstein studies of the effect of wage movements on steel prices in the latter 1950's, which was done under the auspices of this Committee, as you know, is a rather persuasive case for the so-called cost-push theory.

Senator PROXMIRE. Do you think that Eckstein study is sufficiently recent to confirm your conclusions?

Mr. GALBRAITH. The fact that Eckstein ties the price movements at that time to the movements in the basic industries and the fact that we have not had the same movement since would be certainly on my side of the argument; yes.

Senator PROXMIRE. That is all.

Representative REUSS. Mr. Dale, your name has been mentioned. Do you wish to make any statement?

Mr. DALE. Just that I was merely reporting what Mr. Gordon said.

Senator PROXMIRE. You are certainly right, and reporting it very, very clearly. As I said, when I had my colloquy with Mr. Gordon, I thought I was right and he thought he was right, but I was sure that although I thought I was right, I must be wrong.

Mr. HARRIS. Was my explanation correct?

Mr. DALE. I had better shut up.

Representative REUSS. We are very grateful, Mr. Harris and Mr. Galbraith, for your contribution to our hearings. Thank you very much.

We stand adjourned until 10 o'clock tomorrow morning in this place where we will hear from Dr. Raymond Saulnier.

(Whereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 25, 1965.)

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