379

ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

HEARINGS

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CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE.

CHAIRMAN PROXMIRE ANNOUNCES HEARINGS BY THE JOINT ECONOMIC COMMITTEE ON THE ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

Senator William Proxmire (D., Wis.), Chairman of the Joint Economic Committee, today announced that the Committee would hold hearings on the economic outlook and its policy implications beginning Tuesday, June 27. The schedule of witnesses for the three days June 27–29 is attached.

In announcing the hearings, Senator Proxmire said: "The Joint Economic Committee is and has been very much concerned about the state of the economy and the growing prospects that the Nation faces the largest budget deficit since World War II in the coming fiscal year. Although we do not yet have the completely revised official estimates for fiscal 1968, unofficial and semi-official statements which I summed up on the floor of the Senate last Wednesday, June 7, indicate that the administrative deficit is likely to run somewhere between $16 and $29 billion; the cash deficit between $12 and $20 billion; and even on the National Income Account basis, which excludes transactions in capital items, the estimates of the deficit run between $9 and $17 billion.

"Deficits of these magnitudes, if realized, coming on top of the built-in-cost-push inflationary pressures caused by wage and price increases over and above the guidelines, would in all probability bring about a return of excessively high interest rates and tight money conditions similar to, if not worse than, last year. This is a meat-axe approach to the solution of the problems of the Nation which could produce great harm to just those sections of the economy least able to bear its burdens, namely, consumers, small businessmen, farmers, and home buyers.

"In the light of these worsening prospects, the Committee believes it desirable that Congress have the benefit of a fresh review of the economic situation and outlook in order to obtain a proper basis for the reassessment of Government fiscal and monetary policies. We shall have before the Committee representatives of the Administration as well as outside experts to provide the most up-to-date information on the state of the economy and the relative desirability of alternative means of dealing with the situation which their analysis reveals.

"Congress must soon act on spending programs for the coming fiscal year. If we do need a tax increase in addition to economy in expenditures, then we should know this as soon as possible. We also need to know whether the economy is strong enough to require such restraint or whether weaknesses in some sectors make at least some deficit in the budget inevitable, In short, we need to know the facts so Congress can legislate intelligently and soon."

SCHEDULE OF HEARINGS ON THE ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

June 27, 28, and 29, Room 1318, New Senate Office Building

TUESDAY, JUNE 27—10:00 A.M.

Gardner Ackley, Chairman, Council of Economic Advisers

WEDNESDAY, JUNE 28—10:00 A.M. PANEL DISCUSSION

Conditions and Prospects in Financial Markets

Tilford C. Gaines, Vice President, First National Bank of Chicago

Consumer Expectations

George Katona, Professor of Economics and Psychology, Institute for Social Research, the University of Michigan

Prospects for Business Inventories and Spending on Plant and Equipment

Louis J. Paradiso, Associate Director, Office of Business Economics, Department of Commerce

Outlook for Residential Construction

Michael Sumichrast, Director of Economics, National Association of Home Builders

THURSDAY, JUNE 29—10:00 A.M.

Economic Outlook and Recommendations for Economic Policies in the Immediate Future

Paul A. Samuelson, Department of Economics, Massachusetts Institute of Technology

J. Fred Weston, Department of Economics, School of Business, University of California at Los Angeles

ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

TUESDAY, JUNE 27, 1967

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

The joint committee met at 10 a.m., pursuant to call, in room 1318, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Talmadge, and Jordan of Idaho; and Representatives Bolling, Reuss, Moorhead, and Curtis.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order. This morning the committee again opens hearings on the economic outlook and its policy implications. This is in accord with both long-standing precedent, and section 5–b of the Employment Act under which the committee is enjoined from time to time to make such reports and recommendations to the Congress as it deems advisable.

At times the committee has felt that the economic outlook could be reviewed adequately by means of an analysis prepared by the staff; at other times we have resorted to public hearings—at times when critical decisions are before the Congress the committee has done this in midyear.

It is especially important that we conduct this 1967 midyear review of the economic outlook and its policy implications because the Congress faces important decisions, both on spending programs and on the possible need for a tax increase. These decisions must be made soon, and Congress should have before it, in the near future, the best possible guidance as to the state of the economy and the implications of alternative government policies.

This is especially true since various analyses of budget prospects, which I summed up on the floor of the Senate on Wednesday, June 7, indicate that the administrative deficit is likely to run somewhere between $16 billion and $29 billion; the cash deficit between $12 billion and $20 billion; and even on the national income accounts basis, which excludes transactions in capital items, the estimates of the deficit run between $9 billion and $17 billion.

Deficits of these magnitudes, if realized, coming on top of the cost-push inflationary pressures caused by wage and price increases over and above the guidelines, would in all probability bring about a return of excessively high interest rates and tight money conditions similar to, if not worse than, last year. This is a meat-ax approach to the solution of the economic problems of the Nation which could produce great harm to just those least able to bear its burdens; namely, consumers, small businessmen, farmers, and home buyers. Under these circumstances, the committee looks forward with great interest to hearing the witnesses this week.

I call attention, also, to the fact that the Director of the Bureau of the Budget, Dr. Charles L. Schultze, has agreed to furnish the Joint Economic Committee with estimates of the budget—expenditures and receipts—in late July. Should this week's hearings and Budget Director Schultze's report make it desirable, we can hold further hearings later.

I would also like to note, at this point, that the Defense Department, at the instigation of this committee, will begin to issue the new monthly series on Defense Indicators within a few days. In view of the massive impact of military spending on the economy, this series should prove to be a substantial aid to the Congress and the public in gaging the economy.

This morning, we are indeed fortunate and privileged to begin the hearings by hearing from the Honorable Gardner Ackley, Chairman of the Council of Economic Advisers, and one of America's most distinguished and able economists, who is accompanied by the two other distinguished members of the Council of Economic Advisers, Dr. Duesenberry and Dr. Okun.

Chairman Ackley, we are happy to have you with us this morning. You may proceed.

STATEMENT OF GARDNER ACKLEY, CHAIRMAN, AND JAMES S. DUESENBERRY AND ARTHUR M. OKUN, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Mr. ACKLEY. It is a pleasure for the members of the Council of Economic Advisers to appear once again before this distinguished committee. The statement which I have is rather long, I fear. It doesn't quite have the dimensions of a midyear economic report, but it does approach them. I apologize for its length.

Five months ago, the Annual Report of the Council of Economic Advisers for 1967 was transmitted to the Congress. We welcome the opportunity today to review domestic economic developments since that time and to reassess the judgments that we made in January about the profile of economic activity in 1967 and its implications for fiscal and monetary policies. Let me summarize our key conclusions at the outset.

1. *The economy has advanced at a slow pace so far this year—indeed even somewhat more sluggishly than we had anticipated initially.*—The slowdown resulted primarily from a sharp decline in inventory investment. The inventory adjustment, in turn, was a consequence of the excessive speed of the economic advance in early 1966, and of the imbalance between production and final demand that developed when fiscal and monetary brakes had to be applied to moderate that speed.

2. *The resurgence in economic activity during the second half of this year, which we foresaw in January, is clearly on the horizon today.*—There is no longer a significant risk that the inventory adjustment might culminate in a severe and prolonged slowdown, and there is mounting evidence of growing strength in many areas of the economy.

3. *Events so far in 1967 underline the importance of several aims we set forth in January: "to assure that demand does not outrun capacity that movement toward restoration of price stability is maintained, and that monetary policy does not have to be tightened again."*—Recent price developments have reinforced our hopes and expectations that we will make a significant stride toward the restoration of price stability this year. But they provide no grounds for complacency and no latitude for a sharp new spurt in economic activity. The rebound in our international trade performance has been highly encouraging, but it, too, would be jeopardized by hectic economic advance. Current high long-term interest rates, in the face of a strongly expansionary monetary policy, give fair warning of the dangers of a renewed credit squeeze. Such a squeeze could once again starve the housing industry.

4. *In light of the outlook and the aims, there is no escape from the responsible and objective conclusion that personal and corporate income taxes will need to be raised this year to safeguard healthy prosperity.*—A strongly expansionary fiscal and monetary policy was appropriate while the economy was sluggish in the early months of this year, and it was pursued. It still remains appropriate because the economy is not advancing too rapidly today—indeed, some further acceleration will be welcome. But it will not be appropriate for very much longer. A measure of restraint will be needed in the near future to avoid excessive acceleration. The restraint should be applied through fiscal policy, rather than by a tightening of credit.

THE RECENT PATTERN OF ECONOMIC ACTIVITY

The annual report of the Council noted in January that overall demand was reflecting the restraint of last year's monetary and fiscal actions and was not likely to be buoyant in the first half of 1967. It was evident at that time that inflationary pressures had been brought under control by a combination of restraining policy measures. During the early months of 1967, we were bound to see a natural consequence of these actions—a period of economic advance at a slower-than-ideal speed. A major reason for this sluggishness relates to inventories. When the growth of final demand slowed down late last year, the cutback in the growth of production was neither sufficiently prompt nor adequate in many manufacturing industries. In order to restore balance, reductions in industrial output were clearly required in the early months of 1967.

The lagged impact of monetary policy was a second reason for the slowdown. The lingering aftereffects of tight money continued to depress housing production. The Federal Reserve Board had moved promptly and vigorously toward a policy of easier money late in 1966, but activity in residential construction could not rebound overnight.

GROSS NATIONAL PRODUCT

With these forces at work, the economy has been sluggish thus far in 1967. Indeed, it was somewhat more sluggish in the first quarter than we had initially anticipated. In real terms, GNP declined a bit, according to present estimates. In current prices, it increased by only $4½ billion (seasonally adjusted annual rate), a marked contrast to the $14 billion increase in the previous quarter. The movement of

GNP was dominated by a record $11 billion drop in the rate of inventory accumulation. The big swing in stockbuilding had its major impact on durable goods manufacturing, which experienced a decline in output and employment.

Apart from inventories, expenditures increased in most areas. To be sure, the slowdown was intensified by an unexpected and unusual burst of personal saving. There was a $2 billion drop in consumer spending on automobiles. Even so, total consumer outlays advanced nearly $6 billion for the quarter. Meanwhile, Government purchases of goods and services—Federal and State and local—were the key stimulative force, registering a large increase of $8 billion. In sum, including a notable rebound of $1½ billion in net exports and a tiny gain in residential construction activity, total final sales—i.e., GNP excluding inventory investment—registered a brisk advance of more than $15 billion. This growth of final sales actually exceeded the average quarterly increase experienced during 1966. But the $11 billion drag in inventory investment held the GNP gain to small dimensions.

Obviously, we can offer only a most preliminary and tentative appraisal of the pattern of activity in the current quarter. Nevertheless, the available evidence strongly suggests that the increase in GNP is outrunning that of the first quarter by a significant margin, and that real output is renewing its advance. Final sales are likely to repeat approximately the same $15 billion gain registered in the first quarter. The pattern of advance in final sales should differ somewhat from that of the first quarter, with a stronger rise in consumer expenditures, a more moderate advance in Government spending, and a significant gain in homebuilding activity. Meanwhile, the $11 billion dent that inventory investment put into the first quarter's performance will not be repeated. More likely, the decline in inventory investment in the current quarter should range between $4 and $6 billion, with a resulting gain of roughly $10 billion in GNP.

EMPLOYMENT DEVELOPMENTS

Despite the slow pace of economic activity thus far in 1967, the unemployment rate has remained essentially on a plateau at 3¾ percent of the civilian labor force. There has even been a continued decline in the number of long-term unemployed, i.e., those out of work for 15 consecutive weeks or longer. Unfortunately, however, the unemployment rate of nonwhites—and especially of nonwhite teenagers—has risen.

The overall stability in the unemployment rate has reflected, in large measure, a substantial decrease in the civilian labor force. Many women and teenage workers who were not the primary breadwinners for their families simply dropped out of the labor force when jobs were no longer readily available. The stability has also been aided by the eagerness of many firms in retail and wholesale trade and in services to take on additional workers once the labor market loosened up. Apparently, the needs for workers in these areas had not been fully met during 1966. From December to May, trade and services added 400,000 workers to their payrolls. State and local governments also were a major source of job gains, taking on an extra 250,000 workers.

Manufacturing firms did reduce employment by 300,000 in the first 5 months of 1967. A significant part of the adjustment in their use of manpower, however, was achieved by curtailing overtime hours, rather thay by laying off workers. Showing confidence in the longer term outlook, manufacturers maintained their employment remarkably well in the face of a temporary slump in their markets.

PRICES AND WAGES

The first few months of 1967 have brought a welcome moderation of the upward pressures on our overall price structure. Until April, in fact, the all-commodities wholesale index showed a declining trend. In that month, for the first time in several years, the index was actually slightly lower than it had been 12 months earlier. In May, it was only 0.2 percent higher than a year before. Consumer prices have continued to rise in 1967, but at a significantly slower pace than during 1966.

Much of the improvement in these broad indexes was due to the continued decline in the prices of farm products and industrial raw materials from their high peaks of last summer and fall. Those reductions are unlikely to continue and, indeed, are likely to be reversed to some extent.

In other sectors, prices have continued to rise, but generally at a more moderate rate than during 1966. Wholesale prices for finished nonfood manufactured goods have risen slowly but steadily, with nondurables and producer durables leading the way, and consumer durables showing very small increases.

Retail prices for consumer goods other than food have risen somewhat more rapidly than wholesale prices. Prices of consumer services less rent have continued to rise sharply, although the annual rate of increase in the first 4 months of 1967 was below 4 percent, compared to 5½ percent in the 12 months ended last December.

This pattern of price movements reflects both the general reduction in the pressure of demand against available resources and the aftereffects of the inflationary pressures which were generated last year.

The sluggish movement of demand in the past few months has reduced the strains on our productive capacity. With few exceptions, supplies of raw materials have increased relative to demand. The rate of capacity utilization has declined and backlogs of orders for durable goods have been reduced. Despite the stability of the unemployment rate, there are far fewer reports of labor shortages in the manufacturing area. The easing of the pressure of demand has generated reductions in raw material prices and has served to moderate price increases in industrial products.

But although there are fewer labor shortages in the manufacturing area, there is still intense competition for professional, technical, and other skilled workers. At the same time, last year's cost-of-living increase has enlarged the wage demands of workers, both organized and unorganized. And, during the first part of this year, the new minimum wage law had a significant influence on wage costs in some areas. Thus, in spite of the easing of labor markets, wage rates appear to have risen slightly faster during the first few months of this year than during 1966. As in 1966, wage increases in services and construction have apparently run somewhat higher than those of manufacturing workers. Construction settlements have again produced very high rates of increase in wages. On the other hand, labor costs this year have not been raised by the same sizable increase in social security contributions that occurred last year.

As might be expected where productivity gains are typically small, service prices and retail margins have been driven up by higher wage costs. Unit labor costs have also increased in manufacturing, not only because wages have been rising faster than the productivity trend, but also because productivity gains have been temporily retarded by the reduction in output and relative stability of employment. A part of the rise in unit labor costs has been absorbed by declining profit margins, but prices of manufactured goods have also moved up in response to rising wage rates.

In summary, the recent behavior of prices gives us some ground for satisfaction but none for complacency. In our annual report, we pointed out that we expected 1967 to bring progress toward restoring price stability, but that it would take time for the distortions introduced into the economy during the last half of 1965 and the first half of 1966 to work their way through the system. Nothing has occurred which would suggest any change in this basic appraisal. Prices will rise more moderately than during the period between the step-up in our involvement in Vietnam and the respite which became evident last autumn. We will be moving in the right direction. But we will not have fully restored the price stability we seek. This means that the need for restraint in wage and price decisions is no less pressing than in earlier years.

FINANCIAL DEVELOPMENTS

As inflationary pressures moderated in the fall of 1966, the Federal Reserve moved quickly toward an easier monetary policy. Since then, the Federal Reserve has continued to supply the banking system with substantial amounts of additional reserves. The active easing of monetary policy lowered the Treasury bill rate by more than 2 percentage points from its peak last fall. Rates on other short- and intermediate-term securities have also fallen sharply. As a result, thrift institutions are once more able to compete successfully against marketable securities. The flow of funds to thrift institutions this spring has exceeded by a wide margin the flow during the springs of both 1965 and 1966. That, in turn, has increased the availability of mortgage funds and contributed to the gradual recovery of the home building industry. The increase in reserves has also permitted banks and other financial institutions to reduce their borrowing and to rebuild their liquidity.

Though bill rates are at their lowest levels since 1964, bond rates are now quite close to their peak 1966 levels. Bond rates had declined significantly during late 1966 and early 1967 but, starting about in April, they began to move back up. It was at that time that the effects of a strong demand for funds were reinforced by fear of a return to tight money.

Throughout 1967 bond markets have been strained by the extremely heavy borrowing of corporations and State and local governments. Corporations have issued large amounts of bonds in order to reduce their reliance on bank loans and to rebuild their liquidity. State and local authorities, who had postponed bond issues during tight monetary conditions of 1966, have had to increase their borrowing in order to finance necessary expenditures.

Expectations of a tightening of monetary conditions later this year have also served to push up long-term interest rates. Banks have been rebuilding their liquidity. Other lenders have also tended to favor short-term assets because of the possibility of tighter money, and higher interest rates, in coming months. On the other side of the market, the expectation of even higher rates in the future has stimulated some borrowing in anticipation of need and induced borrowers to issue bonds rather than borrow from banks. It is clear that fears of a possible shift toward tight money have played a major role in producing the abnormally wide spread between short- and long-term interest rates.

In recent weeks the increase in bond yields has begun to affect the mortgage market. In spite of the very large flow of funds to thrift institutions, there have been some increases in mortgage rates. Discounts on FHA mortgages have increased appreciably in the secondary market. Thus far, homebuilding has not been significantly affected, but its recovery could be retarded if high long-term interest rates should cause a substantial diversion of funds from the mortgage market.

Outlook For Economic Activity

Recent developments have erased the fears and anxieties that the inventory adjustment might cumulate into a recession. It is now evident that businessmen are calmly and steadily adjusting their inventory positions and are maintaining their plans for a high level of plant and equipment spending. Even durable goods manufacturing, which has borne the brunt of the inventory adjustment, turned in an encouraging preliminary report on May performance, with a 6½-percent rise in orders and a 2½-percent gain in shipments. And recent data demonstrate that housing is definitely recovering.

Prospects for the continuing rebound of the economy rest on a solid foundation, although the precise speed and pattern of the resurgence remains uncertain. The improved performance in the current quarter and the prospect of growing momentum in the year ahead can be simply summarized: The recent rate of advance in final sales should be essentially maintained, while the retarding force of the inventory adjustment is losing its punch.

The sustained rise in final sales should be fueled by continued strong advances in State and local purchases, good gains in homebuilding, and significant—though diminishing—increases in Federal purchases. Net exports and business investment should register only small movements, but probably in an upward direction. The incomes generated in these sectors would support strong gains in consumer outlays. Inventory investment may continue downward for some months. But, once inventory investment stops falling, it is most likely to move gradually upward toward a normal level, thus becoming an expansionary force.

These forces will move demand ahead at an accelerated pace. However, the critical question is whether that prospective strengthening of demand could be accommodated without a tax increase, without impairing continued progress toward price stability, and without a credit squeeze. To answer this question we now proceed to review the factors affecting the key sectors of the economy. This discussion assumes that Federal expenditures follow the January budget program. It also assumes that the economy will not be disrupted by major changes in the international situation or by a prolonged strike in a major industry. But it specifically does not allow for any tax increase or tightening of financial markets.

INVENTORY INVESTMENT

According to preliminary data for April (the latest month for which information is available), inventory investment was proceeding at an annual rate of only about $1 billion. It could even move below this depressed level in the months to come. Although inventory-sales ratios have improved considerably in trade, they are still very high in many manufacturing areas. In interpreting the ratios of inventories to sales, it should be noted that a significant part of the accumulation of manufacturing inventories has been in the defense sector. Moreover, it is important to remember that the sales of some manufacturing industries have been temporarily depressed by the inventory adjustments of their customers, and this makes the ratios look unfavorable. For the overall economy, the ratio of stocks to final sales is still high; but it actually declined in the first quarter, and further progress is likely in the current quarter.

Judging from recent performance and from surveys of businessmen's expectations, there is no reason to expect the typical firm to jettison inventories in the months ahead. Most of the further adjustment of inventories should be achieved through the growth of sales rather than through any significant actual decline in stocks. It is, of course, impossible to know just how low the rate of inventory investment will go. But it should "bottom out" in the second half of the year and at that point no longer be a restraining force. After touching bottom, inventory investment should begin a gradual climb toward its normal prosperity rate of about $7 billion. In the first half of 1968, the recovery of inventories should be a stimulative force in the economy.

RESIDENTIAL CONSTRUCTION

Against the background of our expectations at the start of the year, we are encouraged by the recent recovery of housing. We anticipated in January that housing starts would rise gradually to 1.4 million by the end of 1967, yielding an increase in expenditures for residential structures of between $5 and $6 billion from the end of 1966 to the end of 1967. Housing starts, which rose to a rate of 1.3 million in May, have been running consistently above the track of our projection, and our initial estimates for this year may turn out to be a bit conservative.

After a spurt in housing starts in January and a dramatic inflow of funds to thrift institutions, some observers began predicting a rate of 1½ million starts by midyear. Those who climbed on that optimists' bandwagon are now disappointed with the pace of recovery in housing. But we judged throughout that the rebound from last year's mortgage famine was most likely to be slow and gradual, perhaps even at times uncertain and unsteady.

There are strong forces helping to support an upward trend in homebuilding. The large flow of funds into thrift institutions so far this year has greatly improved the availability of mortgage finance. Vacancy rates, demographic factors, and the healthy performance of consumer incomes assure that there will be demand in 1968 to support a vigorous recovery to—and indeed above—the 1963–65 average of 1½ million starts. But this recovery could not be achieved if there were a return to last year's monetary conditions.

BUSINESS FIXED INVESTMENT

In 1966, the plant and equipment boom was straining the capacity of machinery industries, squeezing financial markets, and swelling imports of capital goods. A halt to this boom was essential to the Nation's economic health. It was achieved through a combination of forces—suspension of the investment tax credit, the direct and indirect impact of tight money, and the moderation in overall economic activity.

Business fixed investment is dipping slightly in the first half of 1967, and planned outlays were revised downward in the latest Commerce-SEC survey. In the same survey, however, businessmen reaffirmed their plans for a gradual upturn in plant and equipment spending in the second half of the year. There is a tendency for firms to keep scaling down their plans for several quarters, once they begin to make downward revisions. This tendency has to be recognized in the appraisal of the outlook, but so does the likely support of the restoration of the investment tax credit, which has now been approved by the Congress and signed into law by the President. The 3-month string of advances in new orders for machinery and equipment also reinforces the prospect of growing strength for plant and equipment.

Business fixed investment is likely to remain on a very high plateau in 1967; and it clearly will not be a major drag on the overall economy in the second half of the year. A return to the frantic advance of 1964–66 is not desirable. But it could become a danger if the economy were booming in 1968.

GOVERNMENT SPENDING

Rapid advances in both State and local purchases and Federal defense outlays have been a dynamic source of fiscal stimulus in the past year and a half. At the State and local level, spending may even be accelerating, accompanied by a rapid expansion of employment. Over the coming year, State and local purchases will continue to register strong increases, probably matching or even topping the $9 billion gain of the past four quarters.

At the Federal level, however, the $15 billion advance of purchases over the past year should not be repeated. The January budget program called for only modest increases in the rate of defense spending from the start to the end of fiscal year 1968. At the present time, plans for defense spending are still being guided by that program. Any appraisal of the outlook must recognize the uncertainty associated with the possibility of new decisions that would alter the January program. But, on the basis of present plans, the increase in Federal purchases over the year ahead should be less than half the gain in the past year.

All in all, purchases by the public sector will continue to be an important expansionary force, although quarterly increases may be about $4 billion rather than the $6 billion average of the past four quarters.

CONSUMPTION

After months of sluggishness, retail sales have most recently registered three monthly gains in a row, according to current provisional estimates. A pickup in automobile sales has been a major contributor. The saving rate is still unusually high, and such a situation has typically been followed by a return to a more normal level. The marked improvement in the liquidity position of households and some recent survey reports on consumer confidence also point in this direction.

It would not be prudent, however, to count on a swift reduction in the saving rate. More conservatively, there are sound grounds for conviction that the saving rate will not rise further. Thus, consumption gains will at least keep pace with advances in disposable incomes.

SUMMARY

Adding all these elements together, without a tax increase or tight money, the prospective increases in residential construction, State, local, and Federal purchases, and in business fixed investment would contribute between $5 and $7 billion a quarter to the advance in GNP. The associated gain in consumer outlays would be perhaps $7 to $9 billion a quarter, even assuming no significant reduction in the rate of personal saving. Once inventory investment turns around, advances in GNP well in excess of $15 billion a quarter would seem likely for the end of this year and the first half of 1968.

This would be too rapid a pace of growth, inconsistent with the stability of prices and interest rates. The productive capacity of our economy is expanding at a rate of around 4 percent a year. Allowing for the price increases which we must expect, GNP would keep pace with the growth of capacity by advancing about $50 billion over the coming year. Since there is some excess industrial capacity today and since a resurgence of the economy would yield a special bonus in productivity gains, we would welcome advances which slightly outpace a $50 billion annual rate. But we could not welcome—indeed, we probably could not safely tolerate—an upsurge that consistently exceeded a $60 billion rate. The experience of late 1965 and early 1966 showed that a very rapid expansion of demand can generate inflationary pressures even when there is still some excess of unused resources in the economy.

Par for the course over the coming year would surely be a gain in GNP somewhere between $50 and $60 billion. Without new policy restraints, the pace of advance would be likely to exceed the upper limit of this range. With an appropriate tax increase to moderate the growth of consumer and business demand, our advance should stay within safe speed limits.

With an appropriate tax increase, we can look forward to continued high employment, progress toward price stability, and a smooth flow of credit.

EMPLOYMENT PROSPECTS

The stability of the unemployment rate has been a remarkable feature of this year's economic record. Both the elasticity of the labor force in response to changing employment conditions and the stability of businesses' employment policies have been gratifying. However, in some ways they have been puzzling and they cannot be counted on to continue with equal force during the summer months. It would not be surprising to see the unemployment rate drift upward to 4 percent in the next few months, even while the pace of activity speeds up.

Such a development would most probably be temporary, however. Assuming a GNP growth of around $55 billion, the unemployment rate should be close to 3¾ percent most of the time in the next year, extending into a third year the best employment performance since the end of the Korean war. Job opportunities should improve in manufacturing without going so far as to recreate last year's bottleneck problems. Indeed, we may expect an increase in the supply of skilled and highly educated workers to ease some existing shortages. An unemployment rate of about 3¾ percent is consistent with balance in our labor markets.

A higher rate of growth of demand would undoubtedly bring about some further reduction in unemployment. But there would also be a marked intensification of labor shortages. The bulk of any increase in demand beyond the amount required to sustain the present level of unemployment would be matched by increases in prices and wages without adding to real output and employment.

In short, an excessive increase in demand will contribute to inflation while giving little benefit to the disadvantaged workers who still suffer from severe unemployment. The main route to a further reduction in unemployment rates over the longer run lies through our expanding and increasingly effective manpower policies.

PRICE PROSPECTS

The road back to price stability is a long and difficult one. One burst of price increases encouraged by an excessive increase in demand leads to a long series of additional ones. One producer's price increase raises the costs and the prices of others. Workers seek to get higher wages to make up for earlier cost-of-living increases and their wage increases are again reflected in cost and price increases. Fortunately, the spiral is not an endless one. After a burst of price increases the economy can gradually return to reasonable price stability. But it takes time and the right conditions to break the spiral. A return to price stability will be delayed if demand pressures generate labor, material, and capacity shortages which give new momentum to the cost-price spiral.

We have made good progress toward a return to reasonable price stability. The rise in prices during 1967 should be significantly smaller than last year. The progress we have made so far should, with the right demand conditions, lay the foundation for further progress. But that progress will occur only if demand moves ahead at a pace which does not much exceed the growth of our productive resources.

FINANCIAL OUTLOOK

Once there is assurance that fiscal actions will make a restrictive monetary policy unnecessary, there should be a change in the climate in financial markets. The pressures on long-term capital markets described earlier should ease and a more normal pattern of interest rates and borrowing will emerge. That pattern may involve some rise in short-term interest rates, accompanied by a downward movement in long-term rates.

There will, of course, be a large volume of security issues in the second half of this year as in the first, but the pressure from these issues should not be exaggerated. The volume of Treasury issues will increase; but the effect of those issues will be partially offset by a large reduction in corporate sales of Treasury securities to finance tax payments.

To keep security markets in balance commercial banks must, of course, have sufficient resources to purchase a substantial volume of securities as well as to accommodate loan demands. The needed resources should be available if the Federal Reserve continues to supply adequate reserves to the banking system. There will be no need for a turnaround in monetary policy if fiscal policy provides the restraint needed to prevent an excessively rapid growth of demand.

THE ROLE OF FISCAL POLICY

The state of economic activity reflects the interaction of private demand and public policy. Underlying the current strengthening of demand in the various sectors of the economy is the impact of the strongly expansionary fiscal monetary policy that has been pursued in the first half of 1967.

There has been a marked and appropriate shift toward stimulus in policy this year. In 1966, fiscal and monetary restraint helped to brake an economy that was going too fast. Much of the fiscal action of last year was temporary in its restraining character, and is no longer holding down the economy. An increase in payroll taxes of $6 million a year preceded the initiation of medicare benefits and contributed a large restrictive fiscal impact, but medicare benefits have since risen to their full program level. The graduated withholding system for personal taxes drew off a substantial volume of consumer purchasing power in 1966, but this spring it was actually a significant expansionary force because of the lower tax liabilities left over on 1966 incomes. The suspension of the invesment credit had an important shortrun impact on capital goods demand, which has now been removed by its restoration.

These changes were reinforced by a further large increase in defense outlays and by the automatic downward effects on revenues of the sluggish pace of the economy. Together, they have brought the Federal budget from its balance of 1966—national income accounts basis—into deficit at an annual rate over $10 billion in the first half of 1967.

New restraining measures have not been called for now because the economy has been sluggish. The expansionary fiscal policy, reinforced by a stimulative monetary policy, fits the economy's needs while inventories are adjusting, while consumers are saving at an unusually high rate, and while the level of homebuilding is still abnormally low. But a large Federal deficit at high employment and an expansionary monetary policy would, in combination, become excessively stimulative as the temporary weakness in private demand gradually wears off. New policy restraints will be needed to take the place of those that operated last year. In terms of economic impact, fiscal restraint could, in principle, come from cutbacks of expenditures as well as tax increases. But there is so far little evidence that Congress will decide to make a major overall reduction in the carefully planned civilian program proposed by the President. Hence, a tax increase will have to provide the main contribution to restraint.

Because the strength of private demand will not burgeon all at once, fiscal policy needs to be tightened gradually and not abruptly. A tax increase will begin to lower the Federal deficit once it takes effect, with the national accounts budget approaching balance by the end of fiscal year 1968.

BROADER POLICY IMPLICATIONS

In concluding this statement, Mr. Chairman, we should like to suggest some generalization of our comments on recent and prospective economic developments and their implications for policy.

Essentially, we wish to reaffirm our view, frequently expressed, that keeping the economy reasonably close to the Employment Act's goal of maximum employment, production, and purchasing power requires the acceptance of flexibility in fiscal and monetary policy. Only if we were willing to tolerate large and prolonged deviations from this goal—either in terms of excessive slack or inflationary pressures—could we set the course of our fiscal policy and then forget it. Staying reasonably close to maximum employment, without overshooting into inflation, requires continued vigilance, and a readiness to act whenever reasonable forecasts show the need for action.

When we are close to noninflationary high employment, and trying to stay there, the requirements of policy are more demanding than when we are far from our goal and trying to reach it. If a ship is known to be miles off course, the steersman needs to turn the wheel in the right direction; but he does not have to calibrate his movement very precisely nor change his setting very often. Once he is on course and trying to stay there, his adjustments need to be both more frequent and more accurately calculated.

Members of the Council have continued to make these points in recent discussions. However, some commentators have greatly exaggerated—and then attacked—the Council's ideas about the so-called fine tuning of economic policy. They correctly stress the limitations of economic knowledge and of human judgment. We are the first to agree that our chart and compass are not all that accurate, nor is the response of the ship to a turn of the wheel so precisely known. But that is no reason to give up trying to steer. The only alternative to sensible steering is aimless drifting.

Some have caricatured our views as implying that the situation of the economy reacts instantly and precisely to the size of the net fiscal stimulus from the budget. We surely do not believe that and have never implied it. The strength of private demand varies from time to time. We would contend, however, that an important part of this variation can be reasonably forecast. For example, it is obvious that, after a period of large accumulation of inventories, or of plant and equipment, or even of consumer durable goods, private demand will sooner or later tend to be weaker than in the absence of this history.

A larger stimulus from policy, or less restraint, will be appropriate. Demographic changes influence the demand for housing and durable goods; major technological innovations or development of new consumer goods may strengthen or weaken private incentives to invest or consume. Where these influences on the strength of private demand can be reasonably foreseen, policy should take them into account.

But we also recognize the importance of unforeseeable shifts in private demand. And even where the direction and probable extent of shifts in the strength of private demand are clear, or the response of private demand to policy changes can be reasonably foreseen, the precise timing can never be forecast with certainty. Thus, national economic policies, however flexible, can never be expected to steer the economy along a precise course of continual full employment without inflation.

But absolute precision in fiscal adjustments is not necessary. The economy is capable of minor diversions from course without disaster. A moderate shortfall of total demand, maintained for a relatively short period of time, will not create massive slack, nor inevitably generate a cumulative spiral of recession. Nor does a moderate excess of demand, if not too long maintained, immediately generate an uncontrollable spiral of inflation. There is a fair amount of inertia in the system which prevents wild gyrations. And this inertial tendency is reinforced as businessmen, workers, and consumers gain confidence that the basic thrust of policies will be to prevent major deviations from course most of the time.

We know, moreover, that sudden changes in fiscal policy can impose significant costs. Government civilian programs cannot be efficiently turned on and off; and unexpected tax changes can hinder business planning. Circumstances do occur, especially in wartime, when the needs of stabilization require us to pay these costs. Normally, however, the pace of economic change is sufficiently slow that the necessary adjustments of policy can be achieved in the course of the Government's annual fiscal plan.

The experience of recent years, in our view, confirms several propositions:

It shows that reasonably accurate forecasts can be made of the strength of private demand and of its response to policy changes;

It demonstrates that flexible policy changes can keep the economy operating close to potential, even in the face of the great uncertainties inevitable in a war situation, when changing defense needs cannot be tailored to the convenience of economic policymakers;

Yet it also proves that the requirements of correct policy are far more demanding when the economy is close to full employment with reasonable price stability and we have high aspirations for maintaining it there.

We have also learned some lessons about the choice of our policy tools. We know that monetary policy can be adjusted on its own timetable and in small increments. And while monetary and fiscal policy complement one another in their impact on total demand, they differ in their relative impact on the subsectors of the economy, and in time lags between action and response are not the same for the two kinds of policy. Monetary policy can therefore be used to reinforce or partially to offset the effects of fiscal policy and to influence the time pattern of restraint or stimulus to the economy.

But we also know that monetary policy should not be asked to carry too large a burden of policy adjustment. While last year's tight money contributed to the curtailment of inflationary pressures, it carried painful costs for some sectors of the economy—notably housing. Yet it did not have a timely impact on plant and equipment spending, inventory accumulation, or consumer demand. Thus, in the effort to achieve a major restraint on total demand, monetary policy created imbalances that were inequitable and could be redressed only slowly—as this year's housing recovery illustrates.

Thus, if our aspirations for the economy's performance are high, and we are not willing to pay the price of excessive reliance on monetary policy, we must be prepared to face up to the need for fiscal flexibility. We must be ready to make fiscal adjustments whenever the failure to do so can be reasonably predicted to imply a significant undershooting or overshooting of our policy goals. Even if we are unable to predict precisely when, we know that sustained overstimulation from the budget will eventually produce inflationary pressures, just as sustained overrestraint will sooner or later create excessive and unacceptable slack.

Despite the sluggishness of the past 6 months, the overwhelming consensus among serious students in the economy who take the time to study the numbers is that a strong revival of demand is on the way—one that will produce either unacceptable inflationary pressures or a return to tight money, or more probably both, by early next year at the latest.

Thus the time is rapidly approaching when the economy will need the additional restraint of a tax increase. We are confident that the Congress will respond affirmatively to the recommendations that the President has made for a tax surcharge.

Chairman PROXMIRE. Thank you very much, Chairman Ackley, for your usual persuasive and logical job in justifying the economic program that you recommend.

I would like to ask you some questions first on your assumptions in trying to get a more precise picture, if I can, of what you suggest. You are very emphatic and clear in saying you think we need a tax increase this year. However, as you know, when you came before us in February you indicated as the President had indicated that the tax increase should come on July 1. Obviously we are not going to get a tax increase on July 1. At that time it was a 6-percent surtax.

Are you recommending the same size tax? Should it be a 6-percent tax, larger, smaller; should it be a surtax, and roughly what date? You say this year. Does that mean about October 1, September 1? It certainly doesn't mean January 1, 1968, because that isn't this year unless you are talking about a fiscal year.

Mr. ACKLEY. Our expression "this year" certainly referred to enactment.

Chairman PROXMIRE. It does not refer to the effective date?

Mr. ACKLEY. I was not trying to predict the effective date that precisely.

Chairman PROXMIRE. I am not asking for prediction. I am asking what you think would be called for by the state of the economy.

Mr. ACKLEY. I think we have tried to make very clear that by the end of this year the advance of the economy will be sufficiently rapid that it would threaten the return to inflationary pressures and tight money in the absence of a tax increase.

As to the nature and precise timing of the tax increase, the only proposal that is presently before the Congress is the one that the President made in his State of the Union Message and in the Economic Report and I am unable to go beyond that.

Obviously, enactment of a tax increase to become effective by July 1—other than retroactively—is now unlikely. I would presume that when congressional leadership, including the Chairman of the Ways and Means Committee, agree that they are ready to take up this matter, the President might find it appropriate to send a message of some kind to the Congress in which he would specify additional or altered details of his proposal.

Chairman PROXMIRE. You would be satisfied with that kind of a vague-timing approach to it. You feel that it is not so urgent that we have to act at once, but if the Ways and Means Committee chairman and others feel the time may have come that perhaps January 1 might be an appropriate date?

Mr. ACKLEY. I am not trying to express that judgment, Mr. Chairman. I am only trying to indicate that I am not in a position to announce what further proposals the President might make which would alter this.

Chairman PROXMIRE. We are just trying to get your best economic judgment because you are the principal economist of the administration.

Mr. ACKLEY. We have tried to make clear our judgment that the economy will be advancing by the end of this year at a rate which could not be long sustained without inflation or tight money.

Chairman PROXMIRE. How large a tax increase?

Mr. ACKLEY. Again, I think I will have to say that until the President suggests otherwise, the proposal which he has made is the only proposal that I speak to.

Chairman PROXMIRE. You wouldn't be able to tell us whether that would be only a minimum, that it might be that or larger?

Mr. ACKLEY. On the pure economics of it, it would seem unlikely that a smaller increase would be capable of having the effect that seems to be required.

Chairman PROXMIRE. Can you tell us what your assumptions are as of now, almost 5 months since you made your last report on Federal spending?

Mr. ACKLEY. As we indicated in our statement, Mr. Chairman, the assumptions on the basis of which our economic analysis was prepared were that Federal spending would essentially conform to the budget as submitted by the President in January.

We indicated as well the possibility that there might be some overrun of that—as may often occur during a war period—but our forecast and our prescription for policy were not based on any anticipation of such overrun.

Chairman PROXMIRE. So that if there is a substantial increase above what the President initially requested and you request much more, then it will seem on the basis of your analysis that you will have to have a larger tax increase than 6 percent; is that correct?

You see, all the evidence that we have heard—and we have heard people both inside and outside of Government—they have said that spending is going to be substantially higher than the President requested. I am not saying that the President increased the request. I am saying that the demands of the Vietnam war and possible action on the certificates and so forth will cause you to have essentially more spending.

Mr. ACKLEY. Certainly that can't be ruled out. I don't think there is any administration statement, other than that made by the Secretary of the Treasury before the Senate Finance Committee last Friday, which deals with the possibility of expenditures over and above the January budget.

Chairman PROXMIRE. He made statements at that time, as you know, if we are talking about the same statements, that suggested a substantially larger deficit than the President had estimated last January.

Mr. ACKLEY. I believe he suggested the possibility that revenues might run somewhat under the original estimates and that the revenue estimates made by the joint committee staff might be closer to the mark than those which he had previously suggested. The latest estimate that has been given of expenditures for fiscal 1968, $136.4 billion in the administrative budget, and the revenues implied by what the Secretary said before the Senate Finance Committee would be $122.9 billion, giving a deficit of $13½ billion.

It is true that in addition to this the Secretary referred to a number——

Chairman PROXMIRE. That is a change right there from $8.9 billion. Wasn't that it last January?

Mr. ACKLEY. The budget foresaw a deficit of $8.1 billion. Most of the change from this, as you would see, lies on the revenue side rather than on the expenditure side.

The Secretary referred as well to a number of possible contingencies. These contingencies related only to factors which might increase the deficit, as was appropriate in the consideration of the debt limit. This does not imply that there might not be contingencies on the other side too, perhaps symmetrical ones; but those were not relevant in the consideration of the debt limit.

Chairman PROXMIRE. In view of the fact that the estimated deficit has increased more than 50 percent and in view of the fact that you are now telling us that the outlook for the economy appears, at least in the last half, maybe to be a little more bullish than you anticipated last year, at least as bullish although it has been sluggish in the first half, under those circumstances it seems that you might say that the 6-percent surtax would not be enough and probably should be more. Would that be a fair conclusion?

Mr. ACKLEY. Mr. Chairman, to the extent that the shortfall of revenues reflects a weaker economy in the first half than had been anticipated in January, I am not sure that that conclusion would follow. To the extent that the rise in the deficit reflects lower revenues due to a sluggish economy, it would not seem to call in itself for a larger tax increase.

Chairman PROXMIRE. What assumptions do you make and you may have had them in your statement and I missed them, with regard to the growth of the economy in real terms and in money terms during the coming fiscal year?

Mr. ACKLEY. We suggested that par for the course in terms of a desirable rate of advance would be somewhere between a low of $50 billion and a high of $60 billion.

Chairman PROXMIRE. Those are in money terms?

Mr. ACKLEY. Yes.

Chairman PROXMIRE. Would you break that down to terms of the real growth on a percentage basis?

Mr. OKUN. $50 billion would be a 4-percent real growth and a price increase on the GNP deflator basis of a shade below 2½ percent.

Chairman PROXMIRE. This would result in unemployment of about 3¾ percent?

Mr. ACKLEY. Yes.

Chairman PROXMIRE. It seems to me that on the basis of our experience in the past when we have been able to have a low level of unemployment for a considerable period—and the Korean war was an excellent example of this—that we should be able to get unemployment down lower and growth more substantial than you are suggesting here.

For example, in the Korean period we had a rate of unemployment right after the Korean war, 1952–53, of about 3.1 percent and 2.9 percent. Prices rose 1 percent in the first of these 2 years and one-half of 1 percent in the second. This was partly because we had adjusted to a period of low level unemployment, and your analysis here suggests that the economy is pretty resilient in terms of available employment because employment has not increased. Unemployment has also not increased because the work force has tended to diminish. This suggests a resilience on the growth side and would suggest that we can grow more rapidly than what I think is quite a modest and I think much too limited estimate of how we should grow.

Mr. ACKLEY. Mr. Chairman, the experience of 1952 and 1953 has been frequently cited as a case of an economy able to achieve very low rates of unemployment along with close to price stability. I think a careful study of those years will suggest that that may not be a very reliable guide to the basic ability of our economy at that time or at this time to achieve very low rates of unemployment with price stability. These years followed a burst of very large price increases in the second half of 1950 and in early 1951. The apparent price stability in those years was a combination of rising industrial costs plus rapidly declining farm and raw material prices. During those years farm and raw material prices were essentially collapsing. The ability to achieve apparent price stability with that low a level of unemployment certainly in large part reflected the previous very sharp run up and subsequent collapse in farm and raw material prices.

Chairman PROXMIRE. I wouldn't expect you to get to that level either of unemployment perhaps, or maybe of growth, but I just think that it seems to me that your goals are modest, limited, that we should be pressing for a better rate of real growth than 4 percent and I think we can do it on the basis of all the statistics and information that you have given us and experience.

Mr. ACKLEY. I think the more relevant experience is that of the more recent years. In 1966, for example, the unemployment rate averaged 3.8 percent, and we certainly had an unacceptably rapid rise in prices. I would certainly agree that once any high level of employment is achieved and maintained, pressure on price levels is less strong at that level of employment than when it is moving rapidly up to that level. There are many adjustments that have to take place as employment expands, and those adjustments can be costly for the price level. Nevertheless, it is certainly our view that for the present and for the year ahead we would be wise to aim at an expansion of demand sufficient only to maintain roughly the current rate of unemployment.

I would certainly agree that we should not be satisfied with that, that in the longer run we ought to be able to move closer to really full employment. But an important part of that achievement must rest on the success of our expanding and I think increasingly effective manpower policies, which will help shape the character of the labor force to the character of the demands of the economy.

Chairman PROXMIRE. I will come back to this. My time is up.

I yield to Congressman Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

I ask unanimous consent to have the remarks by William McChesney Martin, Jr., Chairman of the Board of Governors, Federal Reserve System, before the Rotary Club of Toledo on June 26, 1967, made part of the record.

Chairman PROXMIRE. Without objection it is so ordered.

(The statement follows:)

SUMMARY OF REMARKS BY WM. McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, BEFORE THE ROTARY CLUB OF TOLEDO, JUNE 26, 1967

As all of you are undoubtedly aware, the Federal Reserve System moved promptly into a policy of monetary ease last fall as soon as the inflationary forces that marred economic progress in 1966 had been brought under control. This policy of ease, pursuit of which has continued this year, has cushioned the impact on the economy of adjustment to the inflationary excesses of 1966, especially the adjustment to the excessive inventories accumulated during the period of inflationary expectation.

The System's policy of monetary ease, together with stimulative fiscal actions, particularly in the form of higher-than-expected Government expenditures, has been successful in preventing the economic adjustments from becoming cumulative. Now, after only a short pause, the economy is beginning to show signs of moving ahead again.

As a result of the System's expansionary monetary policy, the nation's money supply has increased at an annual rate of 6 per cent this year and total credit outstanding at all commercial banks has expanded at more than an 11 per cent annual rate in the same period. The liquidity of financial institutions generally has improved as has the liquidity of many corporations and of consumers generally.

In the face of such monetary ease, many persons find most puzzling recent financial market developments that have returned long-term interest rates to levels in the neighborhood of their peaks of late last summer, while short-term rates have shown substantial declines and, in some areas, are more than two full percentage points below their 1966 highs.

The explanation lies in the huge demand pressures that have been exerted on the bond market by corporations and by state and local governments trying to raise record amounts of long-term funds. Publicly offered corporate bonds, for example, amounted to approximately $6 billion in the first five months of this year in contrast to $8 billion for the whole of last year and only $5.6 billion in all of 1965.

This concentrated outpouring of new security issues is related to three basic reasons: First, many corporations found their liquidity positions reduced to uncomfortably low levels during the 1966 boom and there has been an understandable desire to rebuild their cash reserves from sources outside the banking system. Secondly, current business spending for plant and equipment has continued at exceptionally high levels requiring more cash than has been generated by internal flows. Similarly, total outlays by states and municipalities, including those for capital improvements, exceed currently available funds by a substantial margin.

Finally, and most important, market participants seem to feel that no matter how high interest rates may be pushed by their efforts to raise long-term funds now, the situation may be even worse before the end of the year. Borrowers, investors, and market professionals all are expecting a large Federal deficit in the fiscal year ahead. They fear that financing such a deficit will put additional heavy pressures on the market and that a deficit of this size, along with resurgence in private demands, harbors the potential of reviving inflationary pressures by the boost it will give to spending and to private incomes, in turn stimulating additional credit demands.

The problem of trying to change market expectations as deeply ingrained as these appear to be is difficult indeed, but change them we must if bond markets are to become less susceptible to upward rate pressures and if we are to avoid the possibility of renewed diversion of funds from mortgage markets that would seriously hamper the recovery of housing.

It is for these reasons that I am firmly convinced that we must have adequate, effective—and above all—prompt tax action that would whittle down the prospective deficit for the coming fiscal year to one of manageable proportions.

From the beginning, I have favored the President's proposal for a 6 per cent surtax. In light of the recovery under way in the economy and the current rate of Government spending, I would be prepared now to support an even higher amount, if it is warranted when appropriations by Congress for Government spending during the coming year have been completed. But we should not delay in coming to grips with the problem, for delay would permit inflationary forces to gain momentum as well as permit market expectations to become even more deeply embedded.

It goes almost without saying that I am equally in favor of holding down or cutting back Government spending wherever that is possible without impairing the efficient provision of public services the country has determined it wants to have. Ours is a great and a prosperous nation and we can undertake whatever programs we feel we need, so long as we are willing to assume the financial obligations involved. When we fall into the habit of perpetual deficit financing the soundness of our currency and the strength of our economy will eventually be undermined.

From my experience, the American public will support any policy which they are convinced is essential in the national interest. The public recognizes that the war in Vietnam—which after all accounts for the major share of added Government expenditures—must be paid for. I believe that a tax increase now deserves, and will receive, broad public support. I'm confident, too, that Congress will reflect this support and take the actions to provide, in appropriate measure and timing, the fiscal discipline we need to ensure sustained economic progress.

There is another proposal I should like to put before you that in my view is equally deserving of public support and adoption by the Congress. I have come to the conclusion that we should also act now to eliminate the 25 per cent gold cover requirement against Federal Reserve notes, and thus remove any uncertainty concerning the availability of our gold for official settlements with other governments.

The readiness of the U.S. Treasury to buy and sell gold at the fixed price of $35 an ounce in transactions with foreign monetary authorities has greatly contributed to the willingness of foreign monetary authorities and private foreign residents to hold dollar reserves and working balances. As a result, the dollar has attained a unique position in international commerce and finance, and the universal acceptability of dollars has greatly facilitated the record expansion of international trade. Since 1950 world trade has tripled, rising from less than $60 billion to $180 billion last year. Thus, the availability of U.S. monetary gold holdings to meet international convertibility needs is a matter of vital importance not only to the United States but to the entire present system of international payments on which the free world relies.

Over the years ahead, the continued growth of U.S. economic activity will require continuing monetary expansion consistent with a stable dollar. Under prospective conditions, it appears all but certain that the gold certificate reserve ratio of Federal Reserve Banks, for domestic monetary purposes alone, will steadily decline, even if gold sales to foreign monetary authorities are small. Of course, any substantial further outflow of gold would accentuate the decline.

At the end of May our total gold stock amounted to $13.2 billion, of which almost $10.0 billion was earmarked as the 25 percent reserve required against Federal Reserve notes outstanding. This left "free gold" totaling $3.2 billion. The steady increase in Federal Reserve notes in circulation each year to meet the needs of a growing economy amounts to about $2 billion, thus reducing the "free gold" by about $500 million per year. Net sales of monetary gold for domestic industrial and artistic uses approximate another $150 million per year. Future purchases and sales of gold by official foreigners cannot be predicted, but so long as the United States continues to run large balance-of-payments deficits, it is reasonable to expect additional gold losses for that reason as well.

It seems inevitable then that the removal of the present gold cover requirement must come and the question becomes essentially one of timing. By acting now the Congress could erase any doubt or uncertainty due to this requirement that might affect confidence in the dollar.

There is an inescapable practical requirement that we maintain an adequate gold stock to back up the role of the dollar as a key currency in world trade. Hence the need to conserve our gold stock will continue to exert a disciplinary influence on monetary and other governmental policies.

All of us need to be mindful that sound money is not established by statute alone. In the end, our nation cannot have sound money unless its monetary and fiscal affairs are well managed. The fundamental elements in keeping our financial house in order are sound and equitable fiscal and monetary policies.

Representative CURTIS. In these summaries Mr. Martin says, "It is for these reasons that I am firmly convinced that we must have adequate, effective—and above all—prompt tax action that would whittle down the prospective deficit for the coming fiscal year to one of manageable proportions."

Skipping, "I would be prepared now to support an even higher amount * * *. But we should not delay in coming to grips with the problem, for delay would permit inflationary forces to gain momentum * * *. I am equally in favor of holding down or cutting back Government spending wherever that is possible * * *" et cetera.

You are familiar with Mr. Martin's remarks, I trust, Mr. Ackley?

Mr. ACKLEY. Yes.

Representative CURTIS. Are you in accord with his presentation?

Mr. ACKLEY. I would say that I am generally in accord with what Mr. Martin had to say on taxes.

Representative CURTIS. Now, what worries me is this term "prompt." During the debt ceiling interrogations of the Secretary of the Treasury before the Ways and Means Committee both in public and private, I tried to find out what was meant by "prompt" tax action. In the budget message of January the decision was made that the tax increase of 6 percent should go into effect July 1. Obviously, the administration has backed away from that date. Mr. Fowler, and I hope I am quoting him accurately, said that from an economic standpoint the administration still wanted to do this.

I then supplied the term "political." I said, "It is for political reasons that the administration doesn't proceed." He did not like the use of the term. I said I was trying to use it as a descriptive term meaning the forces before the Congress, and so forth. What is the administration's judgment? If they think that economically this is necessary, it's strange that the President doesn't send up a message as to whether it should be this amount or something even higher. Moreover, the administration says nothing about cutting back Government spending in the nondefense areas which Mr. Mills, chairman of the Ways and Means Committee, said, if I don't misquote him, he felt was a necessary basis for this. What is the administration's view here? If they mean prompt, what are they doing about it?

Mr. ACKLEY. Mr. Curtis, as you know, I am not the official spokesman for the administration in these matters and I don't feel in position to predict in any precise way what the administration may wish to propose or urge on the Congress beyond what it has already proposed and urged.

I think that Chairman Martin's reference to the need for prompt action related to the need for the public and particularly the financial markets to be assured that this action will in fact be taken. The sooner that recognition can be achieved the better off we will be in eliminating the unfortunate expectations which seem to exist.

Representative CURTIS. In other words, the administration as I interpret it is abandoning leadership in this area and saying let the public lead or let the Congress lead.

Let me refer to the latest annual report of the Bank for International Settlements which comments that the question for U.S. economic policy in 1966 was "To tax or not to tax."

This article goes on to say that the question was answered in an indecisive way and that, as a result, excess demand gathered momentum, having the task of restraint to monetary policy.

Don't we face the same problem later this year, unless the administration moves decisively?

Mr. ACKLEY. Certainly there is no question that as of the end of this year the economy will need active restraint of a tax increase. At this moment, it is not needed as it has not been needed during the year up to this time. When the President's proposals were made in January he made clear that there were uncertainties in the outlook and that these might influence the timing of any action which the Congress might find it appropriate to take. Those uncertainties, it seems to me, now are largely eliminated. The prospect for later this year is for the kind of advance that sooner or later will need to be restrained. I think beyond that I am not in position to go, Mr. Curtis.

Representative CURTIS. Let us go to another tax question.

The reduction in auto and telephone excise taxes, scheduled to take place next spring, will represent about a $300 million loss of revenues in fiscal 1968 and, in effect, a tax reduction of $1.3 billion for calendar 1968 as a whole. Has the administration considered asking for legislation to postpone these reductions, or have you considered it in your economic shop?

Mr. ACKLEY. Quite clearly we have considered it, and the admintration has considered it. When and if the administration has any proposals in this respect, I am sure that they will be submitted to the Congress. Again, I am not in the position to make that proposal at this time. I think it is clear, Mr. Curtis, that something will need to be done about the reduction in the automobile excise that is now scheduled for April 1st, because it implies, as presently scheduled, a 5-percent reduction in the excise rate on new automobiles.

This could amount to as much as $150 on an average car. The anticipation of a reduction of that size would obviously be disturbing to the stability of the automobile market and to the economy; so some kind of action almost surely will need to be taken.

Representative CURTIS. Turning to the expenditure side, I notice in your statement a revision in the expenditure estimate given in the budget of January for fiscal 1968 from $135 billion to $136.4 billion. I am glad to hear that there is some revision. This is the first I have heard about it.

Mr. ACKLEY. I believe, Mr. Congressman, that this larger figure was the estimate which the Secretary of the Treasury and the Director of the Budget tentatively gave to the Senate Finance Committee the other day. There will be, as you know, a new estimate given to this committee sometime late in July. That new estimate might be higher or lower than the latest one.

Representative CURTIS. Before the Ways and Means Committee we couldn't even get that, but the Secretary of the Treasury was willing to accept the assumption made by the Ways and Means Committee that defense expenditures would probably increase by as much as $5 billion. Last week on the floor of the House, when we debated the defense appropriation bill, the members of that committee suggested that the figure may be $8 billion; yet apparently the administration is perfectly willing to get a debt ceiling granted on the assumption of a $5 billion increase. It still is not willing to alter its figures beyond what you have given us here, $136.4 billion.

Mr. ACKLEY. The Secretary's reference to $3 billion of possible additional defense expenditures was as a contingency which he thought it appropriate for the Congress to take into account in legislating on the debt ceiling.

I think that is very different from a prediction on his part.

Representative CURTIS. No; he accepted this.

Mr. ACKLEY. As a relevant contingency. I would suggest that such a contingency exists. Indeed, we know that the President is considering a request for larger troop strength in Vietnam, and until that decision is made one way or the other I think it has to be regarded as a contingency.

Representative CURTIS. We are basing this on things in being. It is the judgment not just of members of the House but of those who try to study these things. This is in the context of what happened last year when everyone—not everyone, but certainly members of the Joint Economic Committee, of the tax committees of the House and Senate, and the expenditure appropriations committees—was suggesting that the President's expenditure estimates of $112.8 billion were way out of line. As late as September 1966 the President repeated this figure; and yet, as we now see, expenditures went up to $126.7 billion. This is the kind of indecisiveness and uncertainty that the administration is presenting to the Congress, while asking the Congress to make judgments on fiscal policy and all of these other economic problems you have presented to us. We badly need some firmness on the part of the administration in determining just what it is going to do on the expenditure as well as on the revenue side. I see my time is up.

Mr. ACKLEY. Could I just comment?

Once again I would stress the difference between a contingency allowance and a best estimate of expenditures. As of now, the best estimate of expenditures is one approximately in line with the budget. That obviously can change.

So far as the timing of this goes, I think clearly we do not need the tax increase in effect right now. Clearly, we will need it later. There will be time to take deliberate action to do what needs to be done on a schedule which will be appropriate. If and when there are revisions in expenditures, I am sure that they can be cranked into any consideration of the tax change.

Representative CURTIS. Mr. Chairman, if I could respond here just to get this problem in focus. Before the Ways and Means Committee this point was developed: if the contingency of increased defense expenditures occurred what would the administration do—if anything—about cutting back nondefense spending? Mr. Mills points to the very thing that Mr. Martin points to, but the administration ignores it and refuses to grapple with the problem other than to say, "You can't expect us to revise our nondefense expenditures."

This is the basis I would say for calling the administration indecisive and criticizing their lack of frankness with the American people and the Congress.

Mr. ACKLEY. I would only suggest again that the administration has agreed to provide this committee as of late July with its best estimates of the budget as of that time. I personally expressed the opinion to the chairman of the committee that it would be desirable if these hearings would wait until those figures were before us; but it was decided that this was a better time to have these hearings, and therefore we are here.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Chairman Ackley, you have done your usual very able job of presenting the situation, and I applaud your desire for fine tuning. The only place where I leave you is that you didn't tune quite fine enough for my liking; and particularly I am disappointed that the unemployment needle valve will point at something like a 3¾- or 4-percent unemployment rate, whereas the Joint Economic Committee majority, in its annual report of last March, felt very keenly that the 1967 target ought to be no higher unemployment than 3½ percent—and we are well aware, as you are, that these little quarter- or half-percent differentials in unemployment fall vary largely on Negroes and teenagers, an unfortunate place to have it fall.

As I see it, there are two things that are worrying the administration. One is the possible future boiling of demand from all these sources so that a classic too-much-money-chasing-too-few-goods bottleneck type of inflation might ensue.

The other worry, and it is a very real and immediate one, is a deficit of such size that the financing of the deficit would bring a lot of pressure on the capital market and cause interest rates to tighten very markedly, and if nothing is done about it, there would be a repetition of last summer's unfortunate housing fiasco.

Now, in this conjuncture, where you know that right now you are going to have too great a deficit and too much Federal borrowing unless you do something about it, but you are, in the nature of things, much less sure that there is really going to be a classic demand inflation, it seems to me in such a situation that what this country needs is to recoup about $5 billion worth of additional revenues through plugging tax loopholes. This would avoid excessively tight money, without decreasing materially the somewhat shaky demand that we now have, and thus causing unemployment.

I have said this before. I know it takes some time. I wish we had used the last 6 months to do something about it. I point out that without getting into terribly controversial areas, if you simply did away with the present tax loophole in the capital gains tax for someone who dies owning securities that have appreciated in value, and who presently escapes the tax on that gain, and if you did away with the increasingly scandalous municipal industrial revenue bond loophole, by those two things alone you would gain about $3½ billion.

It would seem to me that a pot of $5 billion, which would be, I believe, the revenue pot involved in the administration's 6-percent surcharge, would be quite possible, and that the sooner Congress gets started on this, the better.

Then later, if a real demand inflation develops, I certainly would be prepared to tax heroically as much as was needed. But, since the real immediate problem is that of a deficit and overheavy Treasury borrowing rather than general demand inflation, why don't you come up tomorrow with a tax-loophole-plugging bill to recoup about $5 billion worth of revenue and then later on even graft on that, if it turns out to be necessary, the straight-out 6-percent surcharge on moderate taxpayers that you are pressing?

I know it is difficult, but unless you start, it is never going to happen.

Mr. ACKLEY. Mr. Reuss, many of these areas of proposed tax reform are ones with which I have a great deal of sympathy. You will recall that proposals to deal with some of these problems—including the capital gains problem—were made by the administration in the consideration leading up to the Revenue Act of 1964. It was pretty clear that no agreement was possible at that time on such changes, and I would guess that we might have a similar experience if those things were proposed now.

I think that it is important that we separate in our discussion and in our legislative actions issues of changes in the tax structure which may be desirable and issues of changes in the tax level that are needed for fiscal policy purposes.

Once in a while it may be possible to combine those. But if we are interested in the flexibility of fiscal policy to deal with the economic situation, I would personally feel it desirable not to try to do two things at once.

Representative REUSS. Don't you think, though, that if you could get through a tax loophole bill such as I have described and put $5 billion extra on an annual basis in the Federal Treasury, you would thereby do an excellent job in relieving tightness on the money market, which is a clear and present danger, without knocking out consumer and investor demand to anywhere near the extent that the $5 billion 6-percent surcharge would do? Isn't that exactly what we need?

Mr. ACKLEY. Of course, if you don't knock off some consumer and business demand, you are not accomplishing the stabilization purpose. I think I might remind you that the subcommittee on fiscal policy of the Joint Economic Committee concluded a year ago that, "A uniform percentage addition to corporate and personal income tax liabilities to be effective for a stated period best satisfies criteria for shortrun stabilizing revenue changes."

I would fully agree with that assessment.

Representative REUSS. Well, that was written, as you say, more than a year ago at a time when we weren't confronted by what now confronts us; namely a high, very high employment situation with staggering Federal budgetary deficits and I am wondering if you try to tune it all on the demand side—to get all the revenues you need by taking them out of the demand side exclusively—if you don't simply slow down growth and increase unemployment more than you want to.

At any rate, I just want to give you my views and to serve notice that unless I am persuaded to the contrary, I am not going to vote for a 6% tax increase bill on moderate income taxpayers at a time when the administration won't even come to Congress and tell us how it would like to have loopholes plugged in such a way as not to so markedly dampen demand.

Mr. ACKLEY. I would make one comment at least. I am prompted to do this by your reference to staggering deficits and also by the chairman's initial comments in opening these hearings. I think some of the numbers that have been tossed around about the size of potential deficits are completely unsupported and I should say preposterous, in my personal judgment.

Representative Reuss. What about a $13 billion administrative budget deficit? Is that not a possibility?

Mr. ACKLEY. It is, indeed.

Representative Reuss. I am trapped on this, having referred for years to the Eisenhower $12 billion deficit as staggering.

Mr. ACKLEY. May I suggest that we keep our perspective on size of deficits. The increase in the economy, in gross national product, since that $12½ billion deficit that was experienced under President Eisenhower would itself translate into something over $20 billion in today's terms. Let's at least keep our perspective adjusted to the growth in the size of the economy.

Representative REUSS. I am retroactively even more staggered than I was then.

On another subject, you don't mention our old friends the wage-price guideposts. I have read your excellent speech on this given a few weeks ago and hope that you and the administration are considering breathing life into the guideposts. It seems to me that they make sense in the kind of high pressure economy we are heading into.

I would hope, too, that you would consider doing what the British and the West Germans are now doing with some success, bringing labor and management into the discussions of the formulation, or in this case the reformulation, of the guideposts. I should think it would be an excellent thing to shoot at a reformulated guidepost for the January 1968 economic report and that in preparation for that it would be an excellent idea to get the AFL–CIO on the one hand and, on the other, the NAM, the Chamber of Commerce, the Business Advisory Council, the CED, and whoever, in for roundtable discussions on how to reconstitute a policy so that the private sector of the economy can work out to a degree its obligations and so that there is some hope of their letting the invisible man at the price and wage bargaining table—namely—the public interest, intrude into their discussions.

Is there any hope of a little revival meeting here?

Mr. ACKLEY. I very much agree with your comments, Mr. Reuss, and I think there is hope and indeed intention.

Representative REUSS. Thank you very much.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Ackley, I am interested in the interest rates. Within the past few months there has been a decided shift from investments in equity capital into bonds because of the very attractive rate that bonds bear. You have already indicated that the revised estimate of the administrative deficit might be of the order of $13.5 billion. There are some people with some degree of expertise who claim that the budget deficit is likely to be as high as $20 billion or $29 billion.

Be that as it may, how is any such deficit as $13.5 billion to be financed and what is this likely to do on interest rates?

Mr. ACKLEY. May I ask my colleague, Mr. Duesenberry, to comment on that question?

Mr. DUESENBERRY. Senator, there will, of course, be a substantial increase in Treasury financing in the second half. Of course, it is normal for there to be a substantial amount of Treasury financing in the second half of the year because of the seasonal movements in revenues.

I should emphasize the fact that in the first half of this year, while there have been no problems of Treasury issues of securities, corporations have sold a very large volume of Treasury securities in making the extra tax payments which were required by last year's changes in the tax law. When we compare the second half of 1967 with the first half, the total strain on the Government bond market—taking account of tax collections as well as of security issues—will not increase as much as appears from the increase in the volume of security issues by the Treasury.

We pointed out in our statement that of course it will be necessary for commercial banks to purchase some securities, whether Treasury securities or other securities doesn't matter, in this market. That will require two things: First, the Federal Reserve System should provide the reserve base which would be required for an expansion of bank assets; and, second, the climate in the security market should be favorable enough in terms of expectations about future interest rates and future Federal Reserve policy to encourage banks and other investors to buy securities in the maturities that are coming on the market.

A lot of our problem in the last few months has been the expectation that rates would rise. This resulted in borrowers' seeking to protect themselves against a future rise in interest rates by borrowing long now, while lenders tried to play the opposite game of avoiding long term commitments until rates had risen. It is essential that we should have a fiscal outlook and a general economic outlook which encourage people to believe that the Federal Reserve will continue to supply reserves and that there won't be a reversion to tight money. We believe it will be possible to balance the flows in the security markets if those conditions are satisfied.

Senator JORDAN. Do you anticipate a lower interest rate, the same interest rate, or a higher interest rate?

Mr. DUESENBERRY. Given the appropriate tax action, we would expect that long-term interest rates would begin to decline. Now it is always a slow process to work long-term interest rates down once they have risen, simply because it requires a change in people's expectations about the future.

On the other side, there should be some pressure on short rates partly because they have been artificially depressed by the desire of people to get liquid assets recently and partly because the Treasury securities which will be forthcoming will have to be at maturities which are toward the short end since the Treasury cannot issue any very-long-term securities. That would put some upward pressure on the shortest maturity rates.

Senator JORDAN. What is the present average time to maturity of Federal borrowing?

Mr. DUESENBERRY. Four years and 5 months.

Senator JORDAN. I think it is pertinent here because I think the tendency is for it to shorten all the while. We are getting into short-term borrowing rather than long-term borrowing. Isn't that the tendency?

Mr. DUESENBERRY. It is true that the average maturity has been declining in recent periods. We don't consider that, in itself, of any great significance. The question is whether the mix of securities being offered by the Treasury is the right mix in terms of the kind of securities that the market will take and what is a useful strategy for the Treasury to pursue in minimizing its effects on the securities market.

Senator JORDAN. I understand the present average of all Federal borrowing, the maturity is under 5 years. Do you think that is a good policy?

Mr. DUESENBERRY. There is, of course, from the standpoint of the Treasury's convenience, a case for having nicely spaced maturities running out over a long period, but the economic significance of the average maturity is very small. In fact, if one issues a very small volume of very-long-term securities, one can raise the average maturity with an almost insignificant effect on the real distribution of maturities. So the average calculation doesn't really reveal very much about the impact of the Treasury on the securities market.

Senator JORDAN. Mr. Ackley, you have indicated that you thought we could see a substantial rise in building. How do you anticipate that in view of the fact that interest rates are still almost prohibitively high in borrowing for building? How do you reconcile those two predictions?

Mr. ACKLEY. I think, Senator, that the primary factor which accounted for the sharp drop in residential construction and to some extent in commercial construction as well, was the lack of availability of mortgage funds rather than high rates of interest.

The structure of market rates last year was such as to destroy the normal flow of funds into the thrift institutions. That has now turned around. The thrift institutions have acquired very large flows of funds, and mortgage money availability does seem to be assured so long as the monetary conditions don't tighten.

Senator JORDAN. But the rates have been almost prohibitive. Some consumer rates have been in excess of 7 percent. This seems to me hardly conducive to expecting the building boom that you are anticipating here.

Mr. ACKLEY. Well, I regard it as unfortunate, too, that mortgage rates are as high as they are, and we would all be happier if they were lower.

Nevertheless, even with the current high level of rates, we have seen this very sharp recovery in housing construction. It seems to us that what is most important to continue that recovery is the continuing availability of funds to the mortgage lending institutions. And that can be achieved.

Senator JORDAN. Turning to another matter, if I still have a minute or two, Mr. Chairman, I am concerned that this year has been said by some to be the year of labor trouble. There is the termination of a lot of labor contracts which will be renewed probably in excess of the guidelines which you have scrapped.

What would you evaluate as the effect that the labor disputes might have, the effect of increasing contracts above the guidelines that you have abandoned?

Mr. ACKLEY. It is correct that there have been a number of labor disputes this year and there has been a strike in the rubber industry now for, I think, over 2 months. There is the possibility that the negotiations in the automobile industry could also result in a strike. That possibility has been referred to by the participants in those negotiations. Surely a major and prolonged strike would have significant implications for the economy. This possibility can't be ruled out, and it is one of the uncertainties of which we must take account.

The level of wage rates and benefits which has been achieved in this year's bargaining appears so far to be somewhat higher than those which resulted in the bargaining last year. I think Mr. Duesenberry may have some figures on that which perhaps he could give you.

Senator JORDAN. I would like to have them.

Mr. DUESENBERRY. I can only give you the figures for manufacturing, but straight-time hourly earnings in manufacturing increased from December 1965 to December 1966 by 4.3 percent. From December 1966 until May 1967, the increase is 1.9 percent, which is an annual rate of 4.6 percent. So if we continued the rate of increase which we had in the first 5 months through the year, we would show 4.6 percent for 1967 as against 4.3 percent for the year 1966. That is for straight-time, hourly earnings.

Of course, the gross earnings are different, because there have been changes in overtime; but the straight-time figure is the one that is most relevant to employers' cost calculations. There has been some acceleration, but not at a pace which shows any explosion of wage increases.

Senator JORDAN. My time is up, but the examples you have cited do show an inflationary trend as measured against your accepted guidelines of a year ago, do they not?

Mr. DUESENBERRY. They are above the guideposts.

Senator JORDAN. Thank you, Mr. Chairman.

Mr. ACKLEY. If I might add one other set of figures that is perhaps relevant here relating to new settlements during 1966, excluding construction, the average settlement, including both wages and fringe benefits, was either 4.1 or 4.5 percent, depending on how you wish to figure it. For the first quarter of this year the corresponding figures are 4.8 or 4.9 percent, again depending on how you want to figure it. So, again, there is a reflection of some increase in the level of current settlements. It is not, however, as large an increase as is sometimes suggested by the rather misleading stories that have appeared in the press evaluating the settlements that have been achieved.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Senator Talmadge?

Senator TALMADGE. Thank you, Mr. Chairman. Chairman Ackley, I was very much impressed with your clear and lucid testimony in chief. I want to ask a few questions about some areas that you didn't touch on directly in your testimony. As I recall, we have had unbalanced budgets now for some 27 or 28 years with the exception of about 3 years. How much longer can our country contend with unbalanced budgets year after year?

Mr. ACKLEY. I would start, Senator, by making the point that, from our standpoint, the most relevant budget is not the administrative budget to which I think you referred, but rather the national income accounts budget; and I think you would find that a somewhat larger number of surpluses or balances have been achieved there. Indeed, in fiscal 1966 the national income accounts budget showed a surplus.

Reverting to your more general proposition, I would say that if our fiscal policy were always ideal and achieved that level of relationship between expenditures and revenues that would assure continued high employment without inflationary pressures, and that if the pursuit of that fiscal policy resulted on the average in some cumulative deficit over a period of years, I would not think that a matter of economic concern.

Obviously, a deficit at the wrong time can be the wrong policy. If we are in a situation of high employment and inflationary pressures, then a deficit—or too large a deficit— is inappropriate. On the other hand, if the economy is operating well below its capacity, with stable prices or falling prices, a deficit is correct and in the interests of the health of the economy and of the Nation.

I think we ought to focus on the fiscal policy which is appropriate to the economic needs of the particular year, and let the fallout be a surplus or a deficit as that may be, and we would then have done the right thing in our Government fiscal policy.

Senator TALMADGE. Let me give you an illustration of what I am talking about. When I came to the Senate 10 years ago, the interest on the national debt was $7 billion a year. It was doubled in 10 years, to over $14 billion at the present time. Now, if we project that, if we have the same situation in the next 10 years, the interest on the national debt by 1977 would be $28 billion. If you projected forward another 10 years, by the year 1987 the interest on the national debt would be $56 billion. If you projected forward another 10 years, by 1997, if we follow the same course, the interest on the national debt would be $112 billion.

When do we call a halt?

Mr. ACKLEY. Mr. Chairman, the rise in the interest payments on the Federal debt has been a product of two things: one, a somewhat larger debt, and, second, sharply rising interest rates. I think it is important that we not continue the latter. Lower interest rates would obviously be helpful in slowing down the increase in our interest payments.

Even so, given the combination of an enlarging Federal debt and higher interest rates, I think it is correct to say that the ratio of interest payments to total Federal revenues has not risen, just as the national debt as a fraction of gross national product has continually fallen over this period.

Obviously, if one keeps using compound interest, as in effect you have done by doubling, one can get some pretty astronomical figures. On the other hand, compound interest applies to the size of the economy as well. I again suggest that we have to recognize that we are in and must and will remain in a steady expanding economy, and that our scale of numerical comparisons has to be adjusted to that fact.

Senator TALMADGE. What is your conclusion on the inflationary factor for the fiscal year that will end June 30? How much did we have? Was it on the order of 2 to 2½ percent?

Mr. ACKLEY. In the fiscal year ending July 1, 1967, I believe the wholesale price index will show a very small rise. In May it was only two-tenths of 1 percent higher than in May of 1966. The consumer price index must be around 2.7 percent higher than a year earlier. The GNP deflator will, I think, have risen by about the same amount as the consumer price index.

Senator TALMADGE. So a good conclusion would be something in the order of 2½ percent?

Mr. ACKLEY. Yes, sir.

Senator TALMADGE. What do you anticipate that it will be in the next fiscal year?

Mr. ACKLEY. Our anticipation, as we spelled it out in our testimony, is that the rate of price increase should be slowing down, that we should do better in the year ahead than we did in 1966. One has to recognize that in the past 6 months or so we have had a decline in farm prices and in some raw materials that we don't expect to continue, that we wouldn't want to continue.

Indeed, farm prices have already turned around. They play an important part in the wholesale price index. But in terms of the movement of the basic structure of costs—which is the most important thing for our international position—we would expect a slowing down of the rate of increase in our cost structure.

Senator TALMADGE. What do you estimate the balance-of-payments deficit will be for the fiscal year 1967?

Mr. ACKLEY. May I ask Mr. Okun to come in on that?

Senator TALMADGE. Yes.

Mr. OKUN. Our balance-of-payments deficit on a liquidity basis last year was $1,400 million.

Chairman PROXMIRE. How much?

Mr. OKUN. $1.4 billion. We think we can hold our own or come close to that this year, despite the increased costs of our defense efforts in Vietnam. Certainly the war has held up and retarded the progress toward equilibrium in our balance of payments, but we have managed to accommodate to it without having a deterioration in our international performance. I think it is highly significant that our exports and imports are looking very encouraging. Our foreign trade performance has been improving in recent months.

Senator TALMADGE. In other words, our exports have been going up?

Mr. OKUN. Yes, sir.

Senator TALMADGE. Imports have likewise gone up, have they not?

Mr. OKUN. Yes, generally, but at a slower pace and with occasional interruptions as in recent months.

Senator TALMADGE. The balance between exports and imports in 1967 was less, was it not?

Mr. OKUN. That is true, and much of this reflected an unusual surge in imports which in turn came in, because——

Senator TALMADGE. A high level of prosperity?

Mr. OKUN. A high level of prosperity and perhaps an excessive level of capacity utilization in some manufacturing industries.

Senator TALMADGE. If you anticipate we will have considerable economic surge the latter half of this year, wouldn't that also mean that imports will perhaps go up at that time, particularly if we have a shortage of some goods, as some economists think we might if our economy accelerates rapidly in the last half of this year?

Mr. OKUN. Yes, I would think we would consider that a very important reason why we can't tolerate an excessive economic upsurge. We want an advance that is healthy. It certainly will be reflected in growing imports, but we think it is consistent with a continuation in the improvement of our foreign trade performance, providing we can keep that advance within a healthy range.

Senator TALMADGE. I am sorry. My time is up. I did want to comment on something that the distinguished Senator from Idaho mentioned a moment ago.

Chairman PROXMIRE. Go right ahead.

Senator TALMADGE. Like the Senator from Idaho, I likewise am concerned about the short-term duration of our interest-bearing public debt. According to the Treasury Bulletin of May 1967, our average length of our debt now is 4 years and 5 months, which I believe is historically the shortest it has been at any time within my knowledge. Ninety-nine billion of that debt will mature this year. It seems to me that that will place tremendous competition with private business and States and local governments and county governments, who likewise would be going into the bond market to secure their needs of capital.

I think our Government would be wise indeed if it took some action to lengthen our public debt, because in effect as these maturities become due in a shorter and shorter period, it seems to me that we are in great danger, if we haven't already, of monetising our national debt. I think it would be wise, Mr. Chairman, if that were given some immediate consideration. I know a request was made to Ways and Means that these notes, if you can call a 10-year maturity a note, be extended, the ceiling on the interest rates for 10 years, and Ways and Means and the Finance Committee have already approved for 7 years. And I think that is one of the things that needs direction in our country or else we are going to have constant and continued high interest rates from now on, and perhaps great danger of more inflation likewise.

Thank you very much.

Chairman PROXMIRE. Congressman Bolling?

Representative BOLLING. Thank you, Mr. Chairman.

Mr. Ackley, I am sorry that I wasn't here to hear your presentation. I have had an opportunity, however, to glance over your statement. I have also been informed as to some of your answers to a particular line of questioning. I gather from the statement that, while you are pretty sure that we need a tax increase, you are relatively unsure at this time as to the timing of a tax increase. Is that a fair statement?

Mr. ACKLEY. In the sense that the timing is not something to which I can appropriately speak. I tried to say, Mr. Bolling, that I did not feel in the position to forecast when the President might make further proposals or the Congress might consider them. I think that is not my province.

Representative BOLLING. I think that is a very wise position. Now that leads me to a question really. In his testimony before the Committee on Rules, the very able chairman of the House Committee on

Ways and Means emphasized the argument that it was very important that the Rules Committee grant a rule promptly and that the House act promptly on the restoration of the investment credit.

In order to answer the argument made against the proposal that some of us have made for years that the Executive be given a limited and circumscribed authority to raise and lower taxes, he made the argument that prompt action by the Rules Committee and by the House was essential to answer the argument that it would be wise to give the Executive a certain limited authority to effect the tax take of the Federal Government.

The chairman of the Committee on Ways and Means was very successful in his request to the Rules Committee and in the House, but something happened in another body that seems to have delayed action of the Congress as a whole substantially, and it leads me to inquire as to what the position of the Council is today with regard to—and I am purposely vague—to a limited and circumscribed authority vested in the President to change upward and downward the tax rate of the Federal Government.

Mr. ACKLEY. Speaking only as an economist, I would think it might be useful if the Congress would agree to grant the President such authority. I don't regard it as a necessary precondition of an adequate degree of fiscal flexibility. I believe that Congress has demonstrated, despite this most recent incident, an ability to act promptly on tax changes. And, indeed, in this most recent case, inasmuch as the effective date of the proposed tax change was a date already past, the need for urgency was not quite as great as it might have been if we had been talking about a tax change whose effective date depended on the passage of the legislation.

I am confident that Congress can act as rapidly as is necessary. Although it might be useful to have some flexibility on the part of the Executive, I don't regard that as crucial.

Representative BOLLING. I find myself again in the position that I often find myself in, that as a Member of Congress I am less optimistic about the institution than you are.

Thank you.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Ackley, I must first commend you and your associates on this excellent presentation. It is clear and very helpful. I don't want to embarrass you, but I would like to get back to this question of timing raised by Congressman Bolling. As I understood your testimony, I gather that you believe that the Congress should act promptly on enacting the tax legislation. I will come to the effective date later. Did you not say that we should act promptly so that people in the financial markets would know that a tax increase is coming?

Mr. ACKLEY. That is correct. The earlier people are convinced that that is there will be a tax increase, the more healthy our financial markets would be. As to the timing of the effectiveness of the tax, certainly the proposal was originally that it be enacted in July. I think it still is appropriate to stay as close as we can come to that date as is feasible and appropriate.

I would point out that we don't need the tax increase in effect now. We won't need it in effect in July. There is time for the Congress and the President to take timely action to meet the need that we foresee.

Representative MOORHEAD. I notice that you keep referring in your testimony to the word "appropriate" tax increase. Do I understand your testimony to mean that the appropriate tax increase is the one suggested last January but that you reserve the right to make a different type of proposal in the next few weeks?

Mr. ACKLEY. I think the President always has that right and undoubtedly will exercise it if he feels it "appropriate."

Representative MOORHEAD. That is a very good word. Were the figures you gave us for the deficit for the next year on the administrative budget those of the Council of Economic Advisers or of the Treasury Department? And if they were from Treasury, do you have any different estimates?

Mr. ACKLEY. The figures I gave were, I believe, those that could have been derived from the testimony of the Secretary of the Treasury and the Budget Director before the Senate Finance Committee. We do not make independent estimates of it. I would hope that we could wait until the Budget Bureau submits its most recent estimates next month to this committee.

Representative MOORHEAD. One of the things that has concerned us on the Hill is these figures of estimating deficits over $20 billion. Does the Council have any comments on whether or not there could be deficits of that magnitude?

Mr. ACKLEY. Again, I don't feel it appropriate for me to get into a discussion of what precise estimate of the deficit the Director of the Budget will give this committee next month. I have referred only to the figures which other and more appropriate spokesmen of the administration have so far used. I don't say that those will turn out to be the exact figures that the Director of the Budget will present. I did try to suggest that figures of a very much higher magnitude seem to me quite unlikely.

Representative MOORHEAD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Moorhead.

I would like to just say a word first, before I continue my questioning along the line I was on on the tax increase, about Congressman Reuss' suggestion that he was disinclined to vote for a tax increase unless there was a recommendation for tax reforms. You might take this up with the appropriate authority. I think it would be a refreshing, and maybe a refreshingly shocking proposal, if we got from the administration a proposal to, for instance, change the oil depletion allowance, plug that loophole. I am certain about this, that it is very difficult for Congress to move ahead with a tax reform bill when we have this gaping, conspicuous loophole which everybody recognizes as perhaps the most inequitable.

But it is clearly impossible for us to do anything about this loophole if we don't get support from the administration on the basis of the past record.

Let me move into this other area. I think you have done, as I said, a masterful job within your limitations, but you cannot tell us what you recommend for the time, the size of the tax increase, if we should have one. But you make it emphatically clear in your judgment now that we should have one by the end of the year. You can't give us any reestimate on spending or on the deficit, except to say that on the basis of the information you have now you don't see any reason to vary what you said 5 months ago.

Now let me get back to what I think is a pretty strong case not only for deferring the tax increase, as you have indicated we can without any problem through July and maybe August and later, but keeping our options open and not being so insistent that a tax increase must come this year to be effective, perhaps January 1. No. 1, we have unemployment of 3.8 percent. No. 2, hours of work at 40.3 hours a week are lower than they have been in 6 years, indicating resilience. No. 3, the work force declined in the last 6 months, and we have an annual rate of growth of 1½ million a year, indicating again an area of resilience.

No. 4, the plant equalization rate is now 87 percent, which is the lowest it has been since the second quarter, or at least as low as it has been at any time since the second quarter of 1964.

Then I call your attention to the rates of growth. In 1962 we had a rate of growth of 6 percent; 1963, 4 percent; 1964, 5.7 percent; 1965, 4.1 percent; and 1966, 4.1 percent. It is true that we have, of course, a much tighter labor situation than we had during most of those years. At the same time, recognizing this resilience and recognizing that we have done a lot of work in manpower training in the last few years, isn't it possible that we could have a more rapid growth rate than 4 percent in real terms, 4½ or maybe even 5 percent without the kind of inflation which would be unacceptable.

It seems to me that this is a key question in deciding on a tax increase, because obviously if we accept all of your assumptions including the assumption that we shouldn't grow more than 4 percent, we have to buy that tax increase. If we don't take those assumptions and assume we should grow more rapidly and use more of our work force and more of our available plant facilities, it may well be that we should not have that tax increase.

Mr. ACKLEY. Mr. Chairman, you are certainly correct that there is a certain amount of slack in the economy although in some sense concealed——

Chairman PROXMIRE. An impressive slack.

Mr. ACKLEY—(continuing). by the drop in the work force and by the shortening of hours. These are reasons why it would be appropriate in the year ahead for the real growth to exceed 4 percent somewhat, and recapture some of that slack that has crept in in these months of sluggishness. But it is surely clear that the degree of slack in our economy today is very much less than in 1961. The very high rates of growth, around 5 percent, we have averaged since 1961 were possible because we were using up the very large slack that existed in 1961.

I certainly recognize that there can be some disagreement about the importance one should attach to reducing the unemployment rate, on the one hand, and, on the other hand, to the more rapid increase in prices that might accompany the effort to do so. People can differ on the importance they attach to high employment versus price stability. Our objective ought to be to try to get both progressively lower unemployment along with price stability. But I think that, given the structure of our economy and the situation of some cost-push inflation already built in—as you referred to the other day, Mr. Chairman—at this particular time a sober evaluation of these conflicting goals would suggest that we ought to be satisfied with a performance over the year ahead, which would essentially maintain the unemployment rate where it is.

I would point out that our achievement in these past 2 years—and the prospect of its extension into a third year—of an unemployment rate which has averaged below 4 percent is one which maybe today we take lightly. But 4 or 5 years ago most people would have said it would be impossible. Indeed we had for a decade unemployment rates far above this. We have achieved a great deal and we ought not to slip back from what we have achieved. But there are limits to the speed with which we ought to try to progress if we also value, as I think we must, price stability and the preservation of a sound balance of payments.

Chairman PROXMIRE. All right. What I have been trying to build here is a noting of how much tighter our fiscal policy might become. And accepting all the assumptions and your arguments completely, is it not possible at least that we can avoid a tax increase and achieve your objectives if we have a corresponding reduction in spending? I say that not on the basis of the common bromide which is that Congress never cuts the President's spending. Congress almost always cuts the President's request. They have almost every year in the last 20 years. There has not been a single year in the last 20 years in which Congress did not reduce what spending the President requested. In fact, in the past 5 years they reduced him an average of more than $4 billion and as you know there was a reduction of $12 billion in 1953 or 1954. At any rate if Congress would reduce the present immense budget 5 percent it would be a cut substantially bigger than the 6 percent surtax in terms of fiscal impact. If Congress does this and there is a disposition on the part of many in Congress to try to do this, if Congress does it, would it in your judgment have roughly the same economic effect?

Mr. ACKLEY. Yes, indeed, Mr. Chairman, fiscal restraint can be achieved either by reducing expenditures or by raising revenues. I think that on pure fiscal policy grounds—related to the state of the economy, the level of unemployment and so on—it is essentially a matter of indifference which method one might choose.

Chairman PROXMIRE. Isn't there a further argument that a tax increase in the judgment of as eminent and competent authority as the chairman of the House Ways and Means Committee, Wilbur Mills, could conceivably have the effect, because we can't read our crystal ball very clearly, of turning the economy down so that you might get lower revenues with a higher tax rate?

Mr. ACKLEY. I think that it is possible that an excessive cut in expenditures or an excessive increase in taxes could obviously throw us into recession.

Chairman PROXMIRE. The cut in expenditures you are not going to get. If you reduce the expenditures $6 or $7 billion below the present request and we are getting increase largely because of Vietnam and elsewhere; if you confine the increases to a very modest amount you get the effect of giving the President what he asked for in terms of expenditures minus $5 or $6 billion, but an increase over the 1967 fiscal year and no tax increase.

Mr. ACKLEY. I fail to see any economic difference or psychological difference in the effects of fiscal restraint from cutting expenditures or raising taxes.

Chairman PROXMIRE. There is a clear psychological effect on corporations when their tax rates go up. Believe me, as one who has run for office, there is more than just a psychological effect on voters when their taxes go up in an election year.

Mr. ACKLEY. But there is surely a strong psychological effect on corporations when their markets suffer because of a reduction in Government contracts and expenditures. Think of the effect on retail markets in the city of Washington if the number of Federal employees is reduced. I would continue to contend that they have the same economic effect, both immediate and in terms of their feedback, and that the choice between these two has to be made on other grounds than that of securing the proper degree of restraint against inflationery pressures.

Chairman PROXMIRE. Thank you very much.

Congressman Curtis?

Mr. CURTIS. Mr. Chairman, I was concerned when you suggested that these estimates of the deficit for fiscal 1969 were above $20 billion. Let me tell you how we in the Ways and Means Committee reached $29.2. We started with the revised budget deficit of $11 billion, then included the Treasury's own lowered estimates of revenues—down by $1.2 billion as I recall it. Then our Joint Committee on Internal Revenue staff estimated that the falloff in revenues would be another $2.5 billion. There was quite a bit of discussion by the Treasury people and finally the conclusion, as I understand it, was that they thought that this was a more reasonable figure in the light of what had transpired since Treasury made their original estimates.

Then there is $5 billion that is in the budget which could be realized from the sale of participation certificates. This contingency has almost come about already by Congress refusing to grant the authority that the Executive wanted in the sale of these participation certificates. One item that you did mention, a $5 billion increase in defense spending was based on what was already in existence. It was also the judgment of Senator Stennis when he appeared before this subcommittee when we were going into the cost of Vietnam, and it was the judgment of the appropriations people in the House, although they have revised their figures upward as I said. But at any rate there is an additional $5 billion there. There is also the $5.5 billion which is in the budget for increased taxes which is, of course, partly what we are talking about, because if we did increase the taxes by $5.5 billion the deficit would only be at $24.7 billion. But inasmuch as in the budget we use the July 1 date on the assumption that these tax increases would be enacted by then, this is not an unreasonable contingency to contemplate.

So I think, if I may say so, Mr. Ackley, that these estimates are not extreme or preposterous at all. The administration, although not putting its stamp of approval on them, certainly accepted these estimates in telling us what was needed in the debt ceiling.

I think that from an economic standpoint we have to be thinking in terms of prospective deficits in the nature of $29 billion—how much of that from an economic standpoint should be absorbed by increased taxes and how much by deficit financing? Even if you sold the participation certificates, that would have an impact on the financial markets. I am sure you will agree. The administration just last year had the power to sell PC's, but held back because of their desire to avoid a deleterious impact on the private capital market—the demand in the housing industry and so forth. Would you care to comment on what I have just presented?

Mr. ACKLEY. I may sound repetitive, Mr. Curtis, but I will try. The current estimate which the Secretary of the Treasury at least implied before the Senate Finance Committee comes from a new revenue estimate which is $2½ billion lower than the estimate made in May before the House Ways and Means Committee.

Mr. CURTIS. That is where he got his $13 billion?

Mr. ACKLEY. Yes, $13½ billion.

Now, as to the participation sales, of course, it is possible that the Congress might not approve the sale of participation certificates. However, as you suggested, the economic impact of this is essentially irrelevant either on financial markets or on spending.

Mr. CURTIS. But it has a real impact on the budget deficit because under our system of accounting this is really increased expenditures which would be taken care of by the sale of these capital assets. When you eliminate the sale of these capital assets you have to enter the additional $5 billion of expenditures. So that it does become part of the deficit that will have to be financed by Government bonds.

Mr. ACKLEY. It will have to be financed one way or the other and its economic effect is not negligible but essentially insignificant in terms of its effect upon aggregate demand. The loans that would be financed by those participation sales will occur in either case, and calls on the market will either be in the form of participation sales or in regular Treasury securities.

Mr. CURTIS. Let's review this. This is one reason many of us in Ways and Means have felt that we ought to have the PC's under the debt ceiling, so that we can give a truer picture of what is happening in deficit financing. So, coming back to this item, if this $5 billion from sale of participation certificates is included in cutting down the deficit, which it certainly was, in order to have the $8.1 billion deficit that the administration started with, you immediately have to add the $5 billion back into the deficit. However, you say you will finance it. Whether you finance it through Government bonds or through increased taxes or whether you finance it through the contemplated sale of capital assets I think you will agree that there should be an item computed in your deficit.

Mr. ACKLEY. I think you have made, Mr. Curtis, the best case—or at least part of the best case—I know for paying attention to the national income accounts budget rather than the administrative budget.

Mr. CURTIS. I am willing to do that too, Mr. Chairman, but the administrative budget is what we in the Ways and Means Committee, of course, have to consider when we are trying to evaluate, first how much of a deficit there should be, and second, how do we finance that deficit—how much Government bonds, how much new taxes, how much sale of capital assets? So the national accounts budget does not help us on that specific budgetary problem that we are confronted with today, the subject of our present discussion. In the long run, yes, I would like to look at the national accounts budget. It is important and I am sure it gives a more realistic picture over a period of time. But the immediate problems that face this Congress are what to do about taxes, what to do about debt and what to do about expenditures, and these are tied up in the administrative budget. This is the cash flow and this is the thing that I am afraid people on the outside and those in the Congress fail to appreciate because we have no techniques, we have not developed the congressional mechanism for zeroing in on that particular problem other than through the debt ceiling.

I wish I could educate a few members of the news media in this regard who constantly are saying the debt ceiling is just a fiction or just a political maneuver. It has to deal with this very question that I am trying to raise here—how large should the deficit be, what would be its impact if it is a certain size and then, given a deficit of the size of $29 billion or whatever, what is the best way of financing it with the mix of the three things that we have, sale of capital assets, new taxes, and Government bonds?

So that, in this context, I think our $29 billion figure regrettably is the one that we have to grapple with and whose economic impact we must figure out.

Mr. ACKLEY. You will forgive me as an economist if I concentrate on the economic effects of the budget and prefer to analyze it in terms of the national income accounts.

Coming back to your figures which I guess add up to something like $29 billion——

Representative CURTIS. $29.2 billion if my arithmetic is correct, and I think it is.

Mr. ACKLEY. Obviously the defense, $5 billion, and the $5½ billion that you put down for the absence of a tax increase are relevant to the economy.

Representative CURTIS. Certainly.

Mr. ACKLEY. Although we have no basis at the present time for justifying a $5 billion estimate for additional defense expenditures over the budget, we do feel that a tax increase is appropriate even without such an increase. I certainly hope that the Ways and Means Committee in considering the tax question will be focusing on the economic aspects and not on the accounting aspects; on the total impact on financial markets, not on whether it happens to be in participation certificates or Treasury securities. It seems to me that these are the appropriate matters.

I, therefore, can't accept the $29½ billion on its merits, simply because I can't conceive of the fact that the Congress will not vote an appropriate tax increase.

The $5 billion defense overrun was a contingency which the Secretary suggested might be appropriate to take into account if the worst happened. I don't think it should be regarded as a prediction by him or anybody else that, in fact, defense expenditures will be $5 billion higher.

Representative CURTIS. I think the administration should pay a little more attention to the Members of Congress on the appropriate committees that are concerned with this, because they hit the thing pretty closely. I again refer to the testimony of the able Members of Congress who deal with these matters. This is something which is, according to their testimony, already there. Again it comes back to the fact to me that the administration is not being forthright with the Members of Congress about these fiscal matters or with the people of this country. This lack of forthrightness is most significant when the Congress is in the process (as it is right now) of considering appropriation bills.

The President has asked in his budget a total of new obligational authority of $144 billion. He is going to add to that the $125.6 billion carryover power to spend from previous Congresses that he has not used. This gives him a total of $269.6 billion, of which he says he is going to use only $135 billion in fiscal 1968. He could use more or he could use less. He could use at least $20 billion less, according to his own judgment. But this is the point: The President continues to whip up sentiment for these appropriation requests.

If the true fiscal picture had been presented by the President in 1966 as it turned out to be, there would have been an entirely different attitude, I am convinced, adopted by the Congress as well as the people of this country toward appropriation bills, which give him new authority to spend.

The President has castigated the Congress, saying it is a spender. Yet he signed every one of these bills. He has not vetoed them. He has signed them, and he continues to whet the appetite of the people, as I see it, by increasing Vietnam expenditures while maintaining that we don't have to cut back in the nondefense area either by reducing the appropriations requests, or, even more importantly, by restricting the extension of the power to spend that the President already has.

From an economic standpoint, speaking for the Council of Economic Advisers, could you say that the administration has not decided to cut back on nondefense expenditures to make way for these contingencies of increased spending. Am I stating that fairly?

Mr. ACKLEY. Perhaps the only thing to say is that the Budget Director will be presenting revised estimates to this committee next month. I am not in a position to present revised estimates.

Representative CURTIS. The only point I make concerning the Budget Director is why did not he make the revised estimates available while the Ways and Means Committee was being asked to make these major fiscal determinations? My time is up. I had one final line of questions, but I yield and will come back.

Chairman PROXMIRE. I would just like to ask one question and give a commendation and admonition.

The question is that you told us that, in your judgment, if you get the tax increase you requested, prices will probably rise about 2½ percent. What happens if you don't get that price increase? What cost do we have to pay in higher prices if Congress does not pass the the tax increase that you are proposing?

Mr. ACKLEY. I think it would be very difficult and really not appropriate for me to give a rash and ill-considered answer to the question of how much.

Chairman PROXMIRE. Give us one in ranges. This is a question for a competent economist to say what it means when you take $5 or $6 million out or the economy—what likely impact would it have on prices?

Mr. ACKLEY. I think it certainly would make the difference between an improving price record and the prospect of restoring stability in the near future, and the lack of such prospect. If we have a larger price increase in 1967 than in 1966, the prospect of restoring price stability becomes extremely difficult.

Chairman PROXMIRE. Does not that all depend on a crystal ball which is at least cloudy? It depends on whether or not the consumer continues to save at the present rate. It depends on unforeseeable developments in the Vietnam war situation. It depends on liquidation of inventory and depends on all kinds of things in this enormous economy in which there are so many factors at work.

At any rate this brings me to the admonition which is that I hope what you are telling us this morning does not mean that the administration has definitely and finally and firmly decided that they are going to ask for a tax increase. Presumably as long as the President has not come down to update that July 1 suggestion that he made, his options are open. He could let it pass. He could not press for a tax increase.

I hope that you, as the principal economic adviser of the President will keep his eye on the indicators and if they continue to be sluggish—if they don't improve as they did last month—on the suggestion that the economic case is still not there for a tax increase.

Mr. ACKLEY. Since you put it that way, I feel that I have no option but to say very clearly that the position of the administration was in January that the tax increase was needed, and it is even more so on the 27th of June.

Chairman PROXMIRE. But you have told us also that there is no case for a tax increase in July.

Mr. ACKLEY. That is absolutely right.

Chairman PROXMIRE. You don't need it.

Mr. ACKLEY. With all due respect for your observations on the frailities of forecasting, and I must say that I share them all, I think we have no better course than to make the very best judgments we can about the future and to act on those judgments.

Chairman PROXMIRE. But make those judgments as late as you can and then you have the most recent up-to-date information which may well be in August. Suppose the figures for June and July recede again. Suppose industrial production does not increase. Suppose unemployment increases some. Suppose these other indicators go in the other direction.

Mr. ACKLEY. We can suppose what we want, Mr. Chairman. Three months ago I think there would have been grounds for uncertainty. I think those grounds for uncertainty have essentially been eliminated. We have tried to tell you today that whatever uncertainties might have existed in January, to which the President referred and we referred, have been eliminated for all practical purposes. Our considered judgment of the state of the economy and the prospects of the economy call for a tax increase or equivalent fiscal restraint if we wish to avoid an acceleration of price increases and/or a return to tight money, or possibly some of both.

Chairman PROXMIRE. You aren't telling me that you have now shut your mind and are going to ask for a tax increase regardless of what happens before the President actually comes down with a specific request as to the time? You aren't saying that, are you?

Mr. ACKLEY. No, I am not saying that. I am saying that it seems to me that as of now it is clear that a tax increase is appropriate and that as economists, we feel that this is as certain a forecast as we are ever able to make about the state of the economy. Obviously, we can be wrong.

Chairman PROXMIRE. But it will be an even more certain estimate of the economy 2 or 3 months from now when the President has to make a decision.

Mr. ACKLEY. It will be still more certain if we wait until the year after next and see what in fact actually happened; but then it would be too late.

Chairman PROXMIRE. Well, that makes my commendation somewhat weaker. The commendations that I am delighted to hear you say, because I know that this isn't true of all the Members of Congress by a long shot, and in fact I fear it may not apply to a majority of Members of Congress, but you are so right when you say that you should focus in this matter of a tax increase on the economic not the accounting factors, and I think you are the most important person in the administration to keep the President's eye on that. I think there is where the decision should be made.

I am delighted that you put our emphasis on it.

Congressman Curtis?

Representative CURTIS. Just to put in my own caveat, I feel very, very strongly for other economic and fiscal reasons that it is very important that you do move forward with both a tax increase and expenditure reform. I don't think you can temporize in these areas.

The line of questioning to which I would briefly direct myself now is that in its latest annual report, the Bank for International Settlements said that in 1966 our underlying balance-of-payments deficit worsened. In the first quarter of 1967 the deficit at an annual rate was $2.2 billion compared to $1.4 billion for all of 1966.

Looking at that, I was astounded to see the figure for the official reserve transaction basis of a minus $7.3 billion; it is hard to remember when there has ever been a figure like that.

In view of this, do you believe that the deterioration in our underlying position is continuing, and is the administration considering any new steps to deal with the situation, and doesn't our domestic fiscal problems that we have been discussing here have a great bearing on our balance-of-payments position?

Mr. ACKLEY. I would like to ask Mr. Okun, who is our expert on the balance of payments, to respond to those questions, Mr. Curtis, if I may.

Mr. OKUN. In neither of the two measures that we consider most relevant, either the liquidity or the official settlements basis, did our balance-of-payments position deteriorate last year. It remained essentially unchanged on the liquidity basis and improved enormously on official settlements.

I think we would have a difference of opinion with the Bank for International Settlements on how to evaluate our payments position. This improvement in our official settlements position, as you suggested, was indeed short lived. We did get a very big deficit in the first quarter of this year. Many of the same temporary factors that contributed to the surplus of last year just turned around—the change in the financial markets, the strengthening of sterling—both of which led to that enormous deficit for one quarter in the official settlements balance.

Representative CURTIS. Of course, there is this, too; Many people were warned that the short-term money that came in from abroad would go out as fast as it came in, and apparently a lot of that did go out.

Mr. OKUN. It did. I think these are temporary factors and forces. They do shift around. If one averages out over a period of the last five quarters or last year and a half, one finds a better measure of our basic position—which is something like a $1½ billion deficit on both accounts.

Representative CURTIS. So, in other words, the administration doesn't believe these first-quarter figures are evidence of deterioration?

Mr. OKUN. No, we are not prepared to accept them as an evidence of deterioration.

Representative CURTIS. Then the conclusion is that you are not going to do much about it.

Mr. OKUN. We feel that the programs we have undertaken are adequate as we see the prospects ahead. Obviously, there have been a great many steps taken on the balance of payments and these have had their return in bringing our deficit into manageable proportions and stabilizing it there.

Again I would say that our progress on the balance of payments does have to be interpreted in light of the enormous special costs of Vietnam.

Representative CURTIS. What do you think would be the impact the deficit of over $20 billion would have on our international balance of payments?

Mr. OKUN. As Mr. Ackley has suggested, we are not expecting a deficit of that size. But, if we were, I would certainly consider it as inappropriate for our balance of payments as it would be for our domestic economy.

Representative CURTIS. In the event that it were occurring, don't you think we should be doing some shoring up?

Mr. OKUN. I think we should be shoring up our domestic policies to assure that it doesn't.

Representative CURTIS. The U.S. trade balance has recently shown some improvement, largely because of reduced imports. However, since last July, unit labor costs in manufacturing have been rising sharply at an annual rate of about 5 percent. What does this imply for our future export performance and balance of trade?

Mr. OKUN. I would say it is really a leveling off of imports, a marked change from the huge rise of last year that has made the difference. We certainly do expect moderation in our import performance. We are not looking for, nor have we experienced sharp, persistent declines of our competitive position. Our competitive position is good. It did not worsen last year.

Last year, our unit labor costs did not behave better on the average than those of our major trading partners. That was an interruption after many years in which we made consistent progress in having a better record of unit labor costs than nearly any other country in the world.

I think it is important that we do have a good record and, as you are suggesting, that will have a large influence on our export performance over the long run.

In looking at our unit labor cost performance in recent months, it is important to recognize that we have had this dip in productivity gains associated with a temporary slump in manufacturing, and that the healthy resurgence that we foresee should give us a special bonus of productivity gains and thus improve our unit labor cost performance.

Representative CURTIS. One of the things that is of questionable benefit is the fact that some of these countries abroad had inflationary forces that cropped up comparable to ours. If they start handling their fiscal affairs a little better than they are, this would have a real impact on our exports and imports, would it not?

Mr. ACKLEY. Surely the price increases in Western Europe and Japan have well exceeded ours for a number of years, and this is a most important factor in our expectation that we can secure a basic balance in our foreign accounts. We are determined to continue that superior performance, and I think there is every prospect that we will do so.

Representative CURTIS. I wish I could share your optimism. Thank you.

Chairman PROXMIRE. We will convene tomorrow morning at 10 o'clock and hear Tilford C. Gaines, vice president of the First National Bank of Chicago; George Katona, professor of economics and psychology at the Institute for Social Research, the University of Michigan; Louis J. Paradiso, Associate Director, Office of Business Economics, Department of Commerce; and Michael Sumichrast, director of economics, National Association of Home Builders.

The committee stands recessed until tomorrow morning at 10 o'clock.

(Whereupon, at 12:45 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, June 28, 1967.)

(The following letter was sent by Senator Proxmire to Chairman Ackley after the close of the hearings:)

JULY 10, 1967.

Hon. GARDNER ACKLEY,
Chairman, Council of Economic Advisers,
Executive Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: This is with reference to your testimony of June 27 before the Joint Economic Committee. I would like to add the following question, and your response thereto, to the record:

Mr. Ackley, I am struck by a comparison of price movements in the first half of the current year as compared with the first half of last year. In the period December 1965 through May 1966, the Consumer Price Index moved up 1.4 percent. In the period December 1966 through May 1967, the Index moved up 0.8 percent. The lower rate of increase might lead one to the superficial conclusion that weakened demand this year accounts for the more modest price rise. However, when we exclude food, which is responsive to its own particular cycles, the Index has moved up at a rate of 1.2 percent in the last six months as compared with 1.1 percent in the first six months of last year.

I would like to have your assessment of the principal factors underlying the price movements in both periods. I would also appreciate your explanation of the fact that all items, less food, have moved up at a slightly faster rate this year than they have in the same period last year in spite of a weakening of general demand.

With best wishes.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*
Joint Economic Committee.

(Chairman Ackley's subsequent response follows:)

Washington, July 17, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your letter of July 10, relating to my testimony of June 27 before the Joint Economic Committee.

You point out that, between December 1965 and May 1966, the consumer price index (CPI) moved up 1.4%, whereas in the same period a year later, it moved up only 0.8%. However, eliminating food prices, the changes were 1.1% in the earlier period and 1.2% in the more recent. You ask for our evaluation of this in the light of the weaker advance of general demand this year.

In 1966 and 1967, much of the increase in nonfood prices was due to rising service prices. An average increase of 1.8% in prices of consumer *services* accounted for over three-fourths of the increase in nonfood prices in the first five months of 1966. (Services represent less than half of the weight of the nonfood component.) Sharply rising mortgage interest rates—which reflect special financial factors—made a significant contribution to this advance. As pointed out in our 1967 *Annual Report* (pp. 94 and 95), serious question can be raised whether the method of compiling the index does not give excessive weight—in the short run—to changes in mortgage interest rates. Higher wages for all types of labor, including the very skilled and the relatively unskilled, in the face of a steadily increasing demand for services, were the primary factors in the rise in other service prices during this period. Medical services led the general advance.

During the first five months of 1967, service prices were again the principal factor in the rise of nonfood consumer prices. They rose 1.4% in this period, somewhat less than during the same period in 1966, and accounted for about three-fifths of the nonfood increase. The demand for services continued strong, although it was increasing less rapidly than during the previous period. An important factor was that mortgage interest rates were stable or declining in this period. Moreover, some easing of pressures on labor supply may have moderated the upward push of labor costs. On the other hand, the new minimum wage law had a significant upward influence on wage costs in some service industries. The costs of medical care services still showed persistent, large increases—the result of the combination of continued high demand and continued shortages of medical facilities and personnel.

Changes in nonfood *commodity* prices at retail reflect changes both in retail margins and changes in wholesale prices. Between December 1965 and May 1966, *wholesale* prices, excluding farm products, foods, and feeds, rose 1.5%. In the same period this year, the rise was only 0.5%. Narrowing the coverage even further to *manufactured* products (excluding foods, feeds, and other products with a heavy agricultural input), wholesale prices rose 1.4% in the first 5 months of 1966 and 0.6% in the comparable period of 1967. These differences reflect the easing of demand pressures much more clearly than do the comparable changes in consumer prices.

The weakening of general demand in early 1967 was felt most sharply in the *durable goods* industries. Wholesale prices of finished producers' goods, which rose 1.5% in the first 5 months of 1966 under the impact of very strong demand, rose only 0.8% in the first 5 months of 1967.

Wholesale prices of *consumer durables* rose 0.6% from December 1965 to May 1966, but showed no change in the corresponding period of 1967. At the retail level, prices of durable commodities rose 0.1% in the first 5 months of 1966, and 0.8% in the same period of 1967. A large part of this divergent behavior reflects the fact that the 1967 increase in the consumer price index for durable commodities was dominated by a 6.3% rise in used car prices. This one item accounted for the entire rise in the index of retail durable commodity prices.

Nondurable commodities, other than food, have advanced more rapidly this year than last at both wholesale and retail levels. This group rose 0.8% at wholesale in the earlier period and 1.3% in 1967. At retail, the advances were 0.8% in 1966 and 1.2% in 1967.

In part, the behavior of nondurable prices reflects the fact that demand for nondurables has advanced more steadily than for durables. In addition, the minimum wage has this year had a significant effect on costs and prices of nondurables at both the wholesale and retail level. It must also be noted that the rise in gasoline prices this spring contributed significantly to the rise in nondurable prices.

In summary, retail prices for durables, except used cars, have declined slightly in the last few months, whereas they rose slightly in the same period of 1966. Service prices have risen slightly less this year than last, while nondurable commodities have risen more.

It is not entirely clear what this all proves, other than the fact that the *average* advance of retail prices, in any *short* period, is not particularly closely related to the concurrent movement of total demand. Individual movements of particular items may have a short-period impact quite out of proportion to their importance, reflecting special conditions primarily relevant to their own market situations.

Sincerely.

GARDNER ACKLEY, *Chairman,*
Council of Economic Advisers.

ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

WEDNESDAY, JUNE 28,. 1967

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

The joint committee met at 10 a.m., pursuant to recess, in room 1318, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire and Miller; and Representatives Curtis and Brock.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Today we continue our hearings on the economic outlook and its policy implications. We have invited four outstanding economists, each of whom is an expert in at least one important sector of the economy. In this way we hope to inform ourselves as well as possible on four of the major determinants of the economic outlook.

On the subject of "Financial Markets," we have Mr. Tilford C. Gaines, vice president of the First National Bank of Chicago. On the subject of "Consumer Expectations," we have Mr. George Katona, professor of economics and psychology at the Institute for Social Research, the University of Michigan.

On the "Prospects for Business Inventories and Spending on Plant and Equipment," we have Mr. Louis J. Paradiso, Associate Director, Office of Business Economics of the Department of Commerce. And on the "Outlook for Residential Construction," we have Mr. Michael Sumichrast, director of economics, National Association of Home Builders.

Gentlemen, we deeply appreciate your willingness to come here today and give us the benefit of your thinking. I might apologize in advance and say that this is going to be quite a busy day. As you know, we have a recess beginning on Thursday, and for that reason all kinds of things are backed up and happening today. We are going to have a series of rollcall votes on the floor of the Senate. I have two amendments of my own, which I intend to press on the Senate, and speak on. I am hopeful that other members of the committee will come, but we can't count on that.

It may be necessary for us to temporarily recess the hearings, if another member of the committee is not here at that time. I must apologize for the members who are absent, but these are some of the reasons for their absence. Your remarks and answers to questions will be, I am sure, fully studied by the members of the committee.

Mr. Gaines, you may begin.

STATEMENT OF TILFORD C. GAINES, VICE PRESIDENT, FIRST NATIONAL BANK OF CHICAGO

Mr. GAINES. Thank you, Mr. Chairman.

The outlook for the financial markets in the last half of 1967 is not at all encouraging. Most rates of interest probably will be subject to unremitting upward pressure, and there may be insufficient credit available to service all of the demands upon the market.

This forecast of continuing credit strain rests upon relatively optimistic assumptions, optimistic, that is, for financial markets. It is assumed that the acceleration in economic activity in the next 6 months will be moderate, yielding a gross national product for the year of only $779 billion. It is assumed that the deficit in the administrative budget will be of the order of $14 billion, much lower than some figures that have been mentioned. And it is assumed that the Federal Reserve System will continue its present policy of making abundant reserves available to the banking system. If any or a combination of these assumptions should be wrong, it is likely that the error will be in the direction of underestimating the pressures on the credit markets.

Developments in the financial markets during the first half of 1967 have involved a paradox that is without precedent in our modern history. In spite of a progressively easier Federal Reserve policy that has supported a 5.4 percent growth rate in the money supply and 12.8 percent in total bank credit, and in spite of the stagnant performance of the economy, interest rates on long-term investments have risen virtually to last summer's historically high levels. Before attempting to appraise the outlook for the remainder of the year, it is first necessary to explain this paradox and to appraise its significance for the months ahead.

The simple explanation for the present high level of long-term interest rates is that the demands upon the long-term capital market have been excessive relative to the available supply of long-term funds. In the first 6 months of this year, publicly offered corporate bond issues will total $7.7 billion as compared with $3.7 billion in the same period last year. Private placements are somewhat lower this year, but the total of public and private placements will be approximately $11 billion against last year's $8.4 billion—and 1966 was an alltime record year for corporate bond flotations. Tax-exempt State and local bonds sold so far this year total $7.6 billion, substantially more than last year's $6 billion, and 1966 was also a record year for municipal bond sales. Mortgage lending, the other principal user of long-term funds, has not been as large this year as in earlier years, but the shortfall in this area has not been sufficient to offset the excess demands on the bond markets.

There are two related reasons for the huge volume of bond financing this year. First, during the period of rapid business expansion between 1961 and 1965, as corporations committed ever larger amounts of money for plant and equipment, inventories, receivables, and other purposes, there was not a proportionate increase in long-term financing. Corporations relied on bank credit and available internal liquidity to finance a larger and larger part of their outlays. Corporations began funding their debt during 1966, but the demoralized market conditions that developed after midyear forced part of the debt restructuring and liquidity rebuilding over into 1967. Similarly, a number of tax-exempt borrowers were unable to complete their bond financing in the last half of 1966 because interest rates had moved above the statutory limits they were permitted to pay. This circumstance partly explains the flood of municipal bond issues this year.

A second reason for the large volume of corporate bond financing in 1967 has been the uneasiness and uncertainty created by the policy of the Federal Reserve System adopted in the last half of 1966. The period of extreme strain on the banking system last summer and fall made a number of corporate treasurers aware that a time could come when they would be unable to rely upon their banks for additional lines of credit to finance their activities. Funding of short debt in order to reduce reliance on banks and to free up bank lines became a matter of rather urgent importance.

Last year's credit "crunch" has also had an important impact upon the willingness of lenders to commit funds to long-term obligations. The savings and loan associations and mutual savings banks that suffered heavy attrition in their savings accounts when short-term market rates of interest rose above levels they were able or permitted to pay have been anxious this year to build a stronger liquidity base before aggressively seeking new mortgage commitments. A substantial part of the larger flow of savings into savings and loan associations thus far this year has gone to repay debt at the Federal home loan banks and to add to holdings of short-term Government securities. Life insurance companies that found a surprisingly large proportion of their net funds going into policy loans when market rates of interest rose above the contractual loan rate in their policies have had less new money to commit this year. And commercial banks, in particular, have been reluctant to commit funds to long-term obligations after their experience in 1966. All commercial banks suffered attrition from their savings accounts as savers moved money into higher yielding marketable securities. And the larger banks that had relied upon negotiable certificates of deposit money were particularly hard hit last fall when the Federal Reserve System failed to change its regulation "Q" to permit banks to compete for this money and some $3 billion of these deposits were lost to other marketable instruments. Throughout the commercial banking system there is a deep awareness of the need to rebuild liquidity in order to protect against a recurrence of last year's events, with the result that the larger flow of savings money into the banks this year has been used for short-term liquidity purposes rather than for long-term credit commitments.

In economic terminology, what we have witnessed has been a sharp upward shift in the liquidity preference functions of both suppliers and users of funds. The inevitable result has been relatively low short rates and unusually high long rates. This is a situation that the ordinary instruments of Federal Reserve policy are not equipped to deal with. Supplying additional reserves to the banking system, lowering the discount rate, and lowering reserve requirements have helped to feed the economy's insistent liquidity needs, but their effect has been almost wholly on the short-term market and only marginally on the long-term market. Recognizing this fact, and partially in recognition of the responsibility they share for the liquidity preference shift, the Federal Reserve System has purchased a substantial amount of longer term coupon securities in its open market operations. The net result has been to supply longer term funds to the market in the only way the Federal Reserve can; but the sporadic timing of these purchases has undermined their effect upon market confidence and vitiated the stabilizing influence that they might have had on the bond market.

It now appears that the flood of corporate and tax-exempt bond issues during the last half of 1967 may be as large as during the first half. The corporate bond calendar for July already totals $1.5 billion and for August is in excess of $1 billion. Both months could and probably will be larger than those indicated amounts as new issues are announced. Meanwhile, my contacts with corporate officials suggest that a very large backlog of potential new issues exists and that these issues will be registered and brought to market in a steady stream through the balance of this year and into 1968. It is not possible to be absolutely sure of the timing, but it seems reasonably sure that at least $4 to $4½ billion of public issues will come to market in the third quarter and perhaps $3 to $3½ billion in the fourth quarter. These estimates suggest a total of public bond offerings of some $15 billion in 1967, which compares with last year's record $8 billion. The total of publicly and privately placed issues in 1967 could well reach $21 billion, which compares with a record $15.6 billion in 1966. There also is little reason to expect the supply of new tax-exempt bonds to decline. Sales of State and local bonds for new capital purposes might average something more than $1 billion per month, for a 1967 total of $13 to $14 billion, which compares with last year's record $11.2 billion.

The outlook for commercial bank credit expansion is not at all clear. During the first 5 months of this year commercial banks added to their loans and investments by about $7½ billion, of which some $6 billion represented purchases of "other" securities, principally tax-exempt bonds. If this rate of expansion in earning assets were to continue through the balance of the year, allowing for a seasonally more rapid increase in loans during the last half, total loans and investments in commercial banks would increase by approximately $28 to $30 billion, equally divided between loans and investments. It does not seem likely that this rate of expansion will, in fact, be attained.

If one could logically extrapolate the seasonally adjusted deposit growth during the first 5 months of 1967 to an annual total, the growth in bank resources would easily support a $28 to $30 billion growth in bank assets. Time deposits would grow by $28 billion and demand deposits by $8 billion; but such an extrapolation would be an illogical use of statistics. Approximately $3.5 billion of the $14 billion growth in time and savings deposits thus far this year has been in negotiable certificates of deposit at the larger banks, and it does not seem likely after last year's experience with negotiable certificates that the banks will continue to add to the total at this rate. In fact, most of the growth in large certificates of deposit was achieved in the first 2 months of 1967, as banks replaced funds that had been drained off last fall, and the total of such certificates outstanding has been relatively flat since the end of February. Of the remaining $10.5 billion growth in time and savings deposits, much the larger part has been in savings certificates, which reflects the recapturing of savings deposits lost to higher yielding marketable investments last year and thus is a "one shot" windfall. Banks have used this windfall principally to add to their holdings of short-term, tax-exempt bonds and other relatively liquid investments.

My own guess is that bank credit this year will grow by about $25 billion, of which perhaps $14 billion will be in loans of various types and the balance in investments. Time and savings deposits may be up by about $20 billion and demand deposits by $5 billion.

It might be worth noting in passing that the available data suggest that the larger commercial banks have thus far not made too much progress in building their true liquidity to guard against another credit squeeze such as that of last year. Based on data for the banks that report weekly to the Federal Reserve System, including all the larger banks and accounting for about half of all commercial bank assets, the liquidity position at the end of May was little changed from a year earlier. Total deposits had grown by nearly $10 billion, while loans were up by only $3.5 billion. However, $1 billion of the deposit growth was in large negotiable certificates of deposit and $8 billion was in "other" time deposits, principally savings certificates issued to individuals. While the deposits represented by the savings certificates should not be considered quite as "hot" as the negotiable certificates of deposit, they certainly are "hotter" than passbook savings deposits and demand deposits. In large part, this growth in savings certificates represents the interest-sensitive money that was transferred out of savings accounts and savings and loan shares last year when market rates of interest became irresistibly attractive and which could move promptly out of the banking system and into marketable investments if rates of interest were again to offer the same inducement.

The largest imponderable in assessing the financial outlook for the balance of this year is Treasury financing. For purposes of arriving at an estimate of the Treasury's cash requirements, it has been assumed that the administrative budget deficit for 1968 might be $14 billion, with a surcharge of 6 percent on individual and corporate income effective as of January 1, 1968. If this rather modest assumption should prove to be correct, it appears that the Treasury will have to sell approximately $18 billion of direct debt obligations between July and December and $2 billion of participation certificates, for total Treasury cash financing in the last half of 1967 of about $20 billion. Assuming that the Federal Reserve System and the Treasury trust funds in combination purchase $4 billion, the residual amount to be absorbed by other investors will be about $16 billion. The cash flow of nonfinancial corporations may permit them to purchase $8 billion of the total increase in the debt, and commercial banks might add $3 billion or so to their holdings of Government securities. The balance of $5 billion will have to be absorbed by other investors.

Given the anticipated size of Treasury financing in the balance of this year and the expected pressures on the bond market, it seems inevitable that the bulk of the financing will be in short-term obligations such as tax anticipation bills and other bills or notes in the 1- to 2-year maturity range. The Treasury will no doubt make every effort to place as much as possible of the direct debt and the participation certificates in intermediate or long maturities, but it does not seem too likely that the Treasury will be able to do more than a nominal amount of financing in this maturity area.

The tables which accompany this statement provide greater detail on the outlook for financial flows during 1967. (See pp. 53–55.) In conclusion, I would like to suggest some implications of the financial outlook for the balance of this year as I have outlined it.

First, the volume of Treasury financing in short-term obligations in the next few months will almost surely drive all short-term interest rates significantly higher. The low level of Treasury bill rates in recent months has been due partly to the economy's drive for liquidity and partly to the fact that the U.S. Treasury and the Government agencies have, on balance, been retiring short-term debt. If the steadily large supply of new short-term Government securities is accompanied by an improvement in automobile and other durable goods sales, leading to an accelerated increase in finance company paper outstanding, and if commercial bank loan demand should expand faster than anticipated, leading to an increased supply of certificates of deposit in the market, the projected increase in short-term interest rates could be quite substantial.

A corollary of this short-term interest rate outlook is the possibility that these market rates might rise to a point that would induce a flow of savings funds out of the financial institutions—disintermediation—similar to that which occurred last year. Were this to happen, the financial outlook for the balance of this year would be extremely troublesome. However, so long as the Federal Reserve discount rate remains at 4 percent, it should serve to anchor short-term bill yields at a level no higher than 4½ percent, with yields on other instruments scaled up from that level to perhaps a maximum of 5¼ to 5½ percent on U.S. Government agencies and commercial paper, a range of rates that should not result in substantial withdrawals from the savings intermediaries. Still, given the potential volume of short-term financing in the next 6 months, at least some concern over the prospect of renewed disintermediation is justified.

Another conclusion implicit in my analysis is that the pressure of borrowing demand upon the bond markets will probably prevent any significant decline in long-term interest rates from present historically high levels. The demand for capital funds is so intense that further interest-rate increases from present levels are a possibility, but it seems more likely that the extraordinarily high rates now prevailing will tend to discourage some borrowing and thus prevent long-term interest rates from rising much above present levels. In this connection, a good deal will depend upon the policies followed by the Federal Reserve System. A program of steady—and I underscore "steady"—week-by-week purchases of long-term Government securities by the Federal Reserve would be most useful in stabilizing the long-term market and, if offset by sales of Treasury bills, would have no inflationary effect upon money supply or commercial bank credit.

Also, my analysis and the supporting tables suggest that loanable long-term funds will not be available to finance a major recovery in residential construction. My estimates suggest that the net growth in mortgage credit this year may be of the order of $20 billion, approximately equal to last year and consistent with a total of housing starts in the neighborhood of 1.2 to 1.3 million. Of course, a number of other influences such as the availability of intermediate credit lines and the availability of construction labor will have an effect upon the performance of the housing industry. Ultimately, however, any given level of residential construction can be achieved only if the funds are available to finance the homes, and my analysis suggests that the competition from the bond markets will limit the supply of funds available for mortgages.

I should conclude by pointing out that if my assumptions prove to be too optimistic, and I have intentionally made them as optimistic as I could, the outlook for the credit markets could be even more ominous than I have suggested. If economic growth should assume boom proportions, if the budget deficit should be as huge as some forecasts suggest, or if a sizable tax surcharge is not enacted, more serious problems could arise. The Federal Reserve System might find it necessary to move away from the easy policy I have assumed, and the result of additional credit demands in a setting of credit restraint could create almost intolerable pressures on the credit system.

Chairman PROXMIRE. Thank you very much, Mr. Gaines, for a lucid and very fine statement.

(The tables referred to by Mr. Gaines follow:)

TABLE 1.—*Summary of financial flows*

[Federal Reserve flow of funds data in billions of dollars]

	1961	1962	1963	1964	1965	1966	1st quarter 1967 season adjusted annual rate	Forecast, 1967
Funds raised by nonfinancial sectors, total	44.2	54.2	58.5	67.0	72.1	71.1	70.1	80.0
U.S. Government securities	7.7	7.9	5.0	7.1	3.5	6.7	10.6	12.0
Foreign loans and securities	2.6	2.1	3.3	4.4	2.6	1.4	−0.8	2.0
Consumer credit	1.7	5.5	7.3	8.0	9.4	6.9	4.8	6.5
Bank and other loans	3.7	7.8	8.2	10.7	18.3	17.7	14.4	15.0
Municipal securities	4.9	5.0	6.7	5.9	7.4	5.9	9.8	8.5
Corporate securities	7.1	5.1	3.6	5.4	5.4	11.4	14.5	16.0
Mortgages	16.6	20.9	24.4	25.6	25.5	21.0	16.9	20.0
Sources of credit, total	44.2	54.2	58.5	67.0	72.1	71.1	70.1	80.0
U.S. Government lending and change in cash balance	2.6	4.6	2.3	4.0	3.7	7.0	−1.5	6.0
Private insurance and pension reserves	8.6	9.0	10.1	11.1	11.6	12.8	12.8	14.0
Other	6.7	6.2	6.6	7.9	7.8	7.1	−1.8	5.0
Private domestic nonfinance sector	26.3	34.4	39.5	44.1	48.9	44.2	60.6	55.0
Demand deposits and currency	3.8	2.1	5.9	6.5	7.8	2.9	7.6	7.0
Time and savings	20.2	28.1	28.5	28.8	32.6	19.6	48.7	36.0
Commercial banks	9.0	15.0	13.4	13.0	19.5	12.3	32.4	20.0
Savings institutions	11.2	13.0	15.1	15.8	13.1	7.3	16.4	15.0
Private credit market instruments	4.1	2.5	2.3	7.8	6.1	13.3	17.0	7.0
Other	−1.8	1.7	2.8	1.0	2.4	8.4	−12.7	5.0

TABLE 2.—*Cash flow of corporate nonfinancial business*

[Federal Reserve flow of funds, data in billions of dollars]

	1961	1962	1963	1964	1965	1966	1st quarter 1967 season adjusted annual rate	Forecast, 1967
Sources of funds, total	54.5	63.3	65.9	70.6	88.0	96.1	98.2	96
Net savings and inventory valuation adjustment	10.1	12.6	13.1	18.1	20.2	21.2	18.8	19
Capital consumption	25.4	29.2	30.8	32.8	35.1	37.5	39.0	40
Bonds	4.6	4.6	3.9	4.0	5.4	10.2	14.1	15
Stocks	2.5	.6	−.3	1.4	0	1.2	.4	1
Mortgages	1.8	2.9	3.5	3.3	3.2	2.1	2.0	2
Bank loans, not elsewhere classified	.1	2.5	2.9	3.6	9.3	7.7	4.6	5
Trade debt	6.6	4.4	6.0	3.4	7.3	7.7	6.2	6
Other	3.4	6.5	6.0	4.0	7.5	8.5	13.1	8
Uses of funds, total	54.7	63.2	65.9	70.5	88.1	96.2	98.1	96
Fixed investment	35.5	40.0	42.3	47.8	55.1	62.3	65.0	65
Change in inventories	1.5	4.7	4.3	4.4	6.8	10.9	5.5	5
Trade credit	10.0	8.2	8.5	9.1	13.7	10.9	6.7	8
Liquid assets	3.5	4.1	4.3	.7	.6	1.1	9.4	10
Demand deposits and currency	1.7	−.9	−.8	−2.5	−1.9	.7	1.7	1
Time deposits	1.9	3.7	3.9	3.2	3.9	−.7	10.0	4
U.S. Government securities	−.2	.5	.5	−1.4	−2.1	−1.2	−9.7	3
Open market paper	.1	.9	.7	1.5	.7	2.3	7.3	2
Other	4.5	4.6	6.4	5.2	11.2	8.4	9.4	8
Statistical discrepancy	−.3	1.6	.1	3.3	.7	2.6	2.1	----------

TABLE 3.—*Changes in assets and liabilities of all commercial banks in the United States*

[In millions of dollars]

	May 1966 to December 1966			December 1966 to May 1967			May 1966 to May 1967			Forecast, 1967, all banks
	New York City and Chicago	Other reserve city	All other	New York City and Chicago	Other reserve city	All other	New York City and Chicago	Other reserve city	All other	
Loans and investments	$2,963	$3,835	$7,022	−$109	$2,716	$5,063	$2,854	$6,551	$12,085	$25,000
Loans	2,241	3,014	5,415	−1,044	−657	3,151	1,197	2,357	8,566	14,000
U.S. Government securities	926	1,084	40	623	22	−585	1,549	1,106	−545	4,000
Other securities	−204	−263	1,567	312	3,351	2,497	108	3,088	4,064	7,000
Demand deposits, adjusted	1,388	4,356	3,906	−327	−3,175	−1,286	1,061	1,181	2,638	5,000
Time deposits	−2,521	1,690	4,121	2,282	6,234	5,564	−239	7,924	9,685	20,000
Savings	−437	−1,107	(1)	−22	271	(1)	−459	−836	(1)	4,000
Large negotiable CD's	−2,262	181	(1)	1,734	1,730	(1)	−888	1,911	(1)	5,000
Other	538	2,616	(1)	570	4,233	(1)	1,108	6,849	(1)	11,000

TABLE 4.—*Sources of mortgage credit*

[Federal Reserve flow of funds data in billions of dollars]

	1961	1962	1963	1964	1965	1966	1st quarter 1967 season adjusted annual rate	Forecast, 1967
Net change in assets—total	16.9	21.3	25.0	25.4	25.4	20.0	17.5	20.0
1- to 4-family properties—total	11.8	13.4	15.7	15.4	16.0	11.6	11.1	12.7
Mutual savings banks	1.7	2.1	2.6	2.7	2.7	1.7	2.0	2.0
Savings and loan associations	7.0	7.4	9.3	8.0	7.6	3.3	3.4	5.7
Life insurance companies and private pension funds	1.1	1.0	1.3	1.9	1.8	1.6	1.8	1.5
Commercial banks	.8	2.0	2.7	2.3	3.1	2.6	1.4	1.5
U.S. Government	.2	.1	−1.2	−.2	.4	2.5	1.2	2.0
Other	1.0	.8	1.0	.7	.4	−.1	1.3	0
Other mortgages—total	5.1	7.9	9.3	10.0	9.5	8.5	6.4	7.3
Mutual savings banks	.6	1.0	1.3	1.7	1.4	1.1	1.0	1.0
Savings and loan associations	1.7	2.6	2.9	2.4	1.3	.4	.2	.3
Life insurance companies	1.5	2.1	2.7	3.2	3.7	3.6	3.3	3.5
Commercial banks	.8	1.9	2.2	2.2	2.5	2.4	.9	2.0
U.S. Government	.4	.3	.2	.4	.6	.9	1.0	.5
Other	.1	0	0	.1	0	0	0	0

Chairman PROXMIRE. Mr. Katona.

STATEMENT OF GEORGE KATONA, PROFESSOR OF ECONOMICS AND PSYCHOLOGY, INSTITUTE FOR SOCIAL RESEARCH, UNIVERSITY OF MICHIGAN

Mr. KATONA. I am in a position to give you the newest data on our last quarterly survey which have not been released previously.

Consumer expectations about personal financial and general economic developments remained virtually unchanged during the last 3 months. Yet willingness to buy durable goods—houses, automobiles, large appliances—improved somewhat. The proportion of consumers saying that now is a good time to buy durables rose under the impact of war news, expected price increases, frequent and sizable income increases, and an improvement in consumers' savings-debt position. These are the major results of the latest nationwide survey of households conducted by the Survey Research Center of the University of Michigan between late May and late June.

It should be recalled that the Center's Index of Consumer Sentiment, based on five attitudinal questions, deteriorated sharply from its alltime high of 103 reached in the fall of 1965 to 88.3 November–December 1966. In the following 3 months every one of the components of the index advanced and the index reached a level of 92.2. On the basis of the current survey the index is calculated at 94.4.

The increase in the index during the last 3 months was more pronounced among upper than among lower income families. Yet it should be noted that (*a*) the latest improvement is due to an increase in just one out of five components of the index; (*b*) the rate of advance was smaller during the last 3 months than during the preceding 3 months; and (c) the current level of the index is lower than its level a year ago.

During the last few years consumers generally viewed a rising cost of living as an unfavorable development, which induced many people to postpone some of their discretionary purchases. At present, however, an unusually large proportion of people think that automobile prices will be raised. This opinion, held at the time of the Middle East crisis, contributed to the feeling that now is a good time to buy durable goods. The sole component of the Index of Consumer Sentiment which advanced during the last 3 months is the evaluation of buying conditions for durables. It remains to be seen how enduring this particular improvement in sentiment will prove to be. Up to now it has not influenced consumer opinions about prospective business conditions, which have remained less favorable than a year ago.

In view of the sharp deterioration of consumer sentiment during 1966, last winter there was a real threat of a substantial decline in consumers' discretionary expenditures and therefore of a recession in the consumer sector. Yet we skirted the recession, primarily because the income of very many consumers continued to advance. The frequency and extent of income increases may have been related to the recent substantial defense expenditures.

Furthermore, news of unfavorable developments in the economy had a smaller impact of consumers in 1967 than in 1966 because people had become accustomed to such news. Yet there was a continued absence of good news, although the influence of the international situation on domestic business is now seen in a somewhat more favorable manner than 6 months ago.

To place these data in the proper perspective, I would like to say a few words about the very substantial decline in consumer sentiment which has taken place in 1966. Our data give information on not only how sentiment has changed but also on the reasons for the changes, and I shall enumerate briefly the factors which contributed to uncertainty and misgivings in 1966.

In order to view the new findings in their proper perspective, I refer to table 1 which shows the movement of the Survey Research Center's Index of Consumer Sentiment over the last few years.

(Table 1 follows:)

TABLE 1.—*Index of Consumer Sentiment*

Date	All families	Families with incomes of $7,500 and over	Date	All families	Families with incomes of $7,500 and over
	(Fall 1956=100)	(Fall 1959=100)		(Fall 1956=100)	(Fall 1959=100)
1964			1966		
January to February	99.0	104.2	February	99.8	102.9
May to June	98.1	102.4	May	95.8	98.9
September	100.2	106.0	August	91.1	92.4
December	99.4	102.6	November to December	88.3	88.9
1965			1967		
February	101.5	105.1	February	92.2	95.0
May to June	102.2	108.4	May to June	94.4	100.2
August	[1] 103.2	104.8			
November	102.6	107.7			

[1] All-time high. (The Index of Consumer Sentiment is available since 1953.)

It should be noted that the index is not adjusted for population growth or rising incomes. The substantial increase in consumers' discretionary expenditures from 1961 to 1966 reflects both these gains and the advance in the index. It was possible to trace the powerful stimuli which made for a steady growth of optimism and confidence during these years.

I shall list the more recent developments. The tax cut of 1964 not only increased consumers' disposable income, but also made people realize that purchasing power would grow and insure good times. In 1964–65 a larger proportion of families experienced sizable gains in wages or salaries than in any of the preceding 10 years. In 1965 people learned that unemployment was declining. While early in the 1950's the belief that a depression was not in the cards came to be widely held, in 1965 the notion that short recessions were also improbable spread to an increasing number of people. Finally, in 1965, the war in Vietnam was viewed by very many people as contributing to the growth of the domestic economy.

Beginning with early 1966 consumer sentiment deteriorated sharply. Table 1 shows the steady decline of the index from its 1965 level. The decline indicated in advance the easing of automobile demand in the summer of 1966 and its sharp drop in the winter of 1966–67.

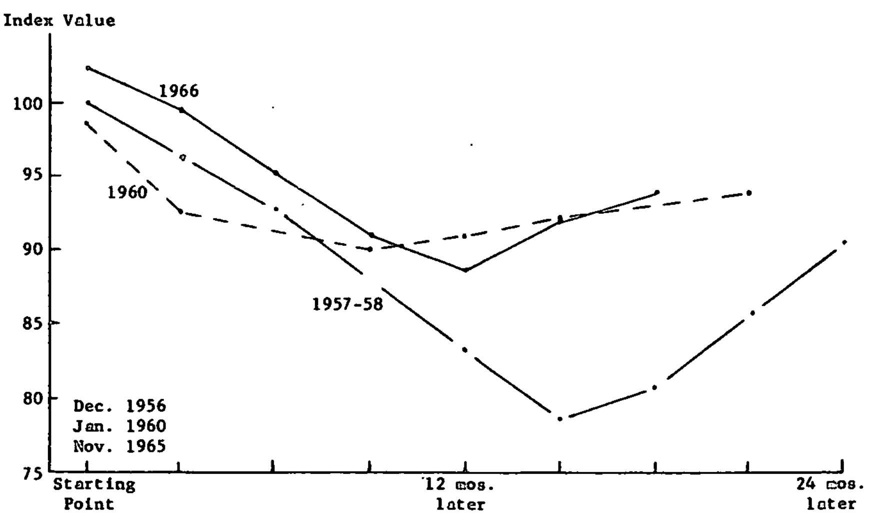
It may be seen from chart 1 that the deterioration in consumer attitudes and expectations in 1966 was similar to that in 1957, though it started at a higher level and terminated earlier and at a higher level than the decline which ushered in the recession of 1958.

(Chart 1 follows:)

CHART 1

SRC Index of Consumer Sentiment in Three Periods

(Five questions)



Source: Survey Research Center, The University of Michigan

Survey data make it possible to indicate the factors which made for uneasiness, uncertainty, and misgivings among very many consumers in 1966—at a time when incomes continued to rise and the economy as a whole remained prosperous.

First of all, in 1966 most Americans knew of rising living costs and expected inflation to continue. Even though on the average incomes have risen more than prices, inflation is generally viewed as bad. Income increases are seen as something deserved, while price increases detract from the enjoyment of the fruits of one's labor.

In 1966 a rather substantial proportion of people expected sizable price increases. (See table 2.) This proportion was much larger than at any time since 1959. In 1966 people thought that because of higher prices they would have to spend more on necessities and therefore could not afford to spend on things they would like to have but need not have immediately.

(Table 2 follows:)

TABLE 2.—*Opinions about the extent of price increases expected during the next 12 months*

[In percent]

	All family units		February 1967 income				
	August 1966	February 1967	Under $3,000	$3,000 to 4,999	$5,000 to 7,499	$7,500 to 9,999	$10,000 and over
Prices will go up in next 12 months by:							
1 to 2	33	36	26	35	39	42	39
3 to 4	12	14	11	13	11	13	18
5	25	21	19	21	21	22	21
6 to 9	4	2	2	2	2	2	4
10 or more	6	5	6	4	5	3	4
Don't know how much prices will increase	7	5	10	6	7	2	2
Prices will not increase	13	17	26	19	15	16	12
Total	100	100	100	100	100	100	100

The questions were: "Thinking about prices in general, I mean the prices of the things you buy—do you think they will go up in the next year or so, or go down, or stay where they are now?" and "How large a price increase do you expect? Of course nobody can know for sure, but would you say that a year from now prices will be about 1 or 2 percent higher, or 5 percent, or closer to 10 percent higher than now, or what?"

Rising interest rates represent the second factor to which the deterioration of consumer sentiment in 1966 may be attributed Approximately 2 out of every 3 consumers heard of rising interest rates. The majority of informed people thought that the higher rates meant trouble for the economy. In the past people had come to associate easy money with good times, so that in 1966 tight money and high interest rates were viewed as adverse factors for the economy as a whole. Thus rising interest rates had a general effect on consumer sentiment beyond their specific effect; namely, to make people think that this is a bad time to buy a house and thus to reduce the frequency of intentions to buy houses for owner occupancy.

Thirdly, in 1966 the majority of consumers expected that income taxes would be increased—close to two-thirds of those with more than $10,000 income thought so. Because the tax cut of 1964 and its beneficial effects for the economy were still well remembered, it is understandable that a tax increase was not seen just as a reduction of disposable income by $20 or $50 or $100 for oneself, but as a decline in American purchasing power and thus as an adverse factor for the economy.

A change in the evaluation of the effects of the Vietnam war on the domestic economy represented the fourth adverse factor in 1966. As I said, most people thought in 1965 that the war would stimulate employment and raise incomes. In 1966 people spoke of inflation and higher taxes when asked about the economic effects of the war. Uncertainty about the size and duration of the war effort spread. Uncertainty always represents a factor that detracts from confidence and makes for postponement of discretionary purchases.

Generally, our studies have shown that the consumer needs constant stimulation. Good news makes a large impact on consumers when it is new. But if the same good news continues for a year or more, it becomes less salient. The year 1966 was characterized by the salience of the unfavorable news which I have just described, while people became habituated to such favorable news as rising incomes and good business trends. The reverse also holds true. By late 1966 and early 1967 there were signs of habituation to the bad news. Information on inflation, on rising interest rates, on the prospect of a tax increase had all become by now old stuff, and people began to note them less frequently when queried about prospects.

Table 3 illustrates that in 1965 many more people reported hearing favorable economic news than unfavorable news. However, as early as in May 1966, 40 percent of all family heads were able to recount unfavorable and only 19 percent favorable news which they had heard. The 1967 data show a smaller excess of unfavorable over favorable news. Similarly, the proportion of people thinking that a recession was likely increased sharply from August 1965 to August 1966, but not thereafter.

(Table 3 appears below:)

TABLE 3.—*News heard about business conditions and opinions about recurrence of a recession*

[In percent]

Date	Economic news heard		Recession	
	Favorable	Unfavorable	Likely or might happen	Not likely
1965				
February	25	20	42	41
August	22	13	32	50
November	29	13	29	46
1966				
February	28	17		
May	19	40		
August	15	43	48	38
November to December	12	34	48	31
1967				
February	18	35	48	36
May to June	21	27	48	35

Only respondents reporting specific economic news heard, or having a definite opinion about a recession, are shown in the table.

The questions were: "Have you heard of any favorable or unfavorable changes in business conditions during the past few months? What did you hear?" "How about a recession and unemployment like we had in 1958 and in winter 1960–61; do you think this will happen again?"

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Table 4 shows recent changes in people's evaluation of business prospects. We do not ask these questions for the purpose of inducing survey respondents to make forecasts. The questions represent an indirect way of ascertaining changes in optimistic or pessimistic attitudes.

(Table 4 follows:)

TABLE 4.—*Opinions about expected business conditions*

[In percent]

	Business conditions expected—			
	During next 12 months		During next 5 years	
	Good times	Bad times	Good times	Bad times
February 1965	75	7	44	20
August 1965	67	9	47	11
November 1965	71	8	47	14
February 1966	69	9	39	18
May 1966	66	13	40	20
August 1966	59	17	38	28
November-December 1966	55	22	33	21
February 1967	62	16	38	23
May-June 1967	60	14	34	21

Only respondents giving a definite answer are shown in the table.

The questions were: "Now turning to business conditions in the country as a whole—do you think that during the next twelve months we'll have good times financially, or bad times, or what?" "Looking ahead, which would you say is more likely—that in the country as a whole we'll have continuous good times during the next five years or so, or that we will have periods of widespread unemployment or depression, or what?"

The deterioration of the relationship between the proportion expecting good times and the proportion expecting bad times from August or November 1965 to December 1966 is shown in table 4, as well as the subsequent small improvement in the relationship. It should be noted (a) that in June 1967 the optimism of 1965 was not restored, and (b) that nevertheless many more people were optimistic than pessimistic.

May I add that tables 3 and 4 present only the proportions with a definite opinion; the frequencies would add to 100 percent if those who answered "Don't know" or "it depends" were included.

In 1966, and today as well, there also was a highly favorable development: The frequency of income increases and of the expectation of further income increases remained large. In this respect we obtained the most favorable date in 15 years of surveys in February 1966, as shown in table 5. At that time 16 percent of all American family units reported that their 1965 income was much higher than their 1964 income and 39 percent that it was somewhat higher. Altogether, 55 percent experienced and 43 percent expected income increases.

(Table 5 follows:)

TABLE 5.—*Change in family income over 1 year* [1]

[In percent]

	Past income change [2]			Expected income change [3]	
	1964 versus 1963	1965 versus 1964	1966 versus 1965	1966 versus 1965	1967 versus 1966
A. All families:					
A lot higher	15	16	14	43	10
A little higher; higher	33	39	34		31
No change	33	28	35	45	46
A little lower; lower	8	8	8	8	4
A lot lower	10	8	8		5
Don't know; not ascertained	1	1	1	4	4
Total	100	100	100	100	100
B. Families with incomes of $7,500 and over:					
A lot higher	21	23	21	51	10
A little higher; higher	44	46	42		40
No change	22	18	24	37	36
A little lower; lower	7	8	6	9	5
A lot lower	5	5	6		5
Don't know; not ascertained	1	[4]	1	3	4
Total	100	100	100	100	100

[1] Data collected in surveys taken in February 1965, 1966, and 1967.

[2] Income in the previous year as compared to income in the year before that. The questions asked in February 1967 followed the determination of the family income in 1966 and were as follows: Was your family's total income higher in 1966 than it was the year before that (1965), or lower, or what? Was it a lot higher (lower) or just a little higher (lower)?

[3] Income expected for the current year as compared to income in the previous year. The questions asked in February 1967 were: Will your family income for this year (1967) be higher or lower than last year (1966)? Do you think it will be a lot higher (lower), or just a little higher (lower)?

[4] Less than one-half of 1 percent.

A year later, in February 1967, the data were less favorable, but only slightly so. At that time 48 percent experienced and 41 percent expected income increases. The proportion of those who in 1 year both experienced and expected income gains remained unusually high at 28 percent. This is the group which, according to our studies, is most strongly stimulated to buy durable goods and to incur installment debt. Favorable income trends thus provide strength to consumer demand and help to explain the fact that in spite of widespread misgivings about inflation, higher interest rates, the prospect of high income taxes, and Vietnam, the economy did not slide into a recession.

The origin of consumer attitudes is rather complex. To news about the settlement of labor disputes with substantial wage increases, some people react favorably and others unfavorably. Optimistic notions are derived from awareness of rising purchasing power and the expectation that one's own income would likewise increase substantially. The fear of inflation, on the other hand, makes for pessimistic notions.

In conclusion, then, the latest survey findings do not indicate a sizable upturn in the consumer sector. Good news, either about personal finances, or the general economic conditions, or the international situation, is needed to revitalize consumer optimism and to stimulate consumer expenditures. Unfavorable news, on the other hand, may enhance uncertainty and uneasiness, and thus promote wait-and-see attitudes.

The current findings do not indicate that a boom or even the large upswing in the consumer sector is in the cards.

Thank you.

(The following information accompanied Mr. Katona's statement:)

METHODOLOGICAL NOTE

Source of Data:

Nationwide surveys with representative samples of consumers conducted by the Survey Research Center every quarter since 1960 and at irregular intervals between 1952 and 1960. The sample size varies between 1300 and 3000 family units.

The Index of Consumer Sentiment:

Constructed from five questions asked in each survey on attitudes toward and expectations about the personal financial situation, general economic conditions, and the market for durable goods.

Background:

In our affluent society consumers have great latitude of action to undertake or postpone discretionary expenditures, primarily by spending larger or smaller amounts of money on durable goods, housing, and leisure-time pursuits, as well as by incurring or not incurring debt. Discretionary expenditures are a function of both consumers' ability to buy and their willingness to buy. Ability to buy depends on income received, and also on the availability of liquid assets and access to credit. Changes in willingness to buy are measured by the Index of Consumer Sentiment.

Performance:

Over the last fifteen years the movements of the Index helped to explain a large part of the substantial fluctuations in purchases of automobiles and other durable goods and foreshadowed forthcoming changes and turning points, for instance, in 1954, 1957, and 1966. Data that serve to evaluate the past performance of the Index have been published in the April 1967 issue of the American Statistician.

Related Studies:

Numerous questions not included in the Index are asked in each quarterly survey. These are questions on reasons for expectations, as well as on the level of information about and the attitudes toward new developments (e.g., changes in prices, taxes, interest rates, etc.). Analysis of these data contributes to an understanding of past and expected trends in consumers' discretionary expenditures. Past studies have been summarized in George Katona's book, The Mass Consumption Society (New York, 1964).

Chairman PROXMIRE. Thank you very much, Mr. Katona, for a fine statement. I understand that your survey has just been completed and this is your first opportunity to disclose it.

Mr. KATONA. Yes, sir. We had our data yesterday on the basis of 90 percent of the sample.

Chairman PROXMIRE. This is the unveiling of your data?

Mr. KATONA. Yes, sir.

Chairman PROXMIRE. We are delighted and flattered that you have chosen this occasion to unveil this information.

Mr. KATONA. The timing was very good.

Chairman PROXMIRE. Mr. Paradiso?

STATEMENT OF LOUIS J. PARADISO, ASSOCIATE DIRECTOR, OFFICE OF BUSINESS ECONOMICS, U.S. DEPARTMENT OF COMMERCE

Mr. PARADISO. Mr. Chairman and members of the Joint Economic Committee, thank you for inviting me to discuss the present position and near-term prospects for new plant and equipment expenditures and business inventories. First, I shall consider the outlook for fixed nonresidential investment.

Prospects for Fixed Nonresidential Investment by Business. No major source of demand has surged so strongly and for so long a period of time as that for fixed capital goods by business. Indeed, the expansion of this sector, which began after the second quarter of 1961, accelerated after mid-1965 due to the sharp upturn in defense ordering and output attending the escalation of the Vietnam war—a recent

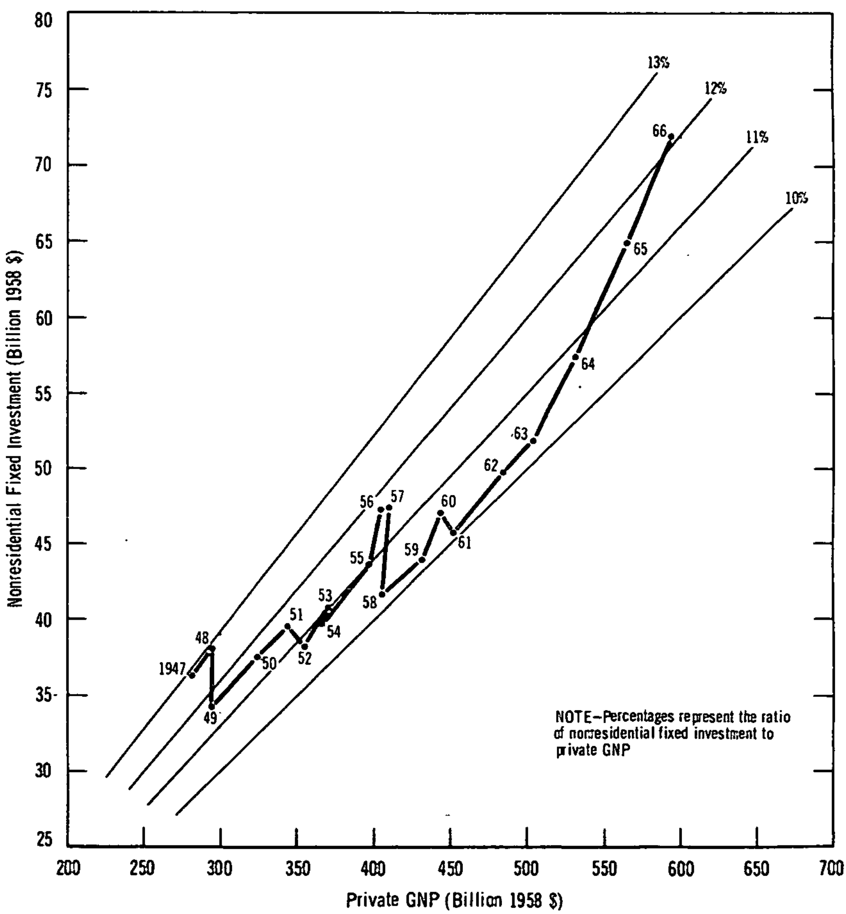
McGraw-Hill survey reported that in 1966 the amount spent by manufacturers for new plant and equipment to produce defense goods was $1.2 billion, or 4 percent of manufacturers' capital expenditures. Inclusion of this type of investment by other industries and of the indirect effects on investment of the defense programs would bolster this amount—and to the continued growth of most other sources of private demand.

The 1966 investment "superboom," as some have characterized it, absorbed a larger proportion of our total output than in the exceptionally high investment years 1956 and 1957; real nonresidential fixed investment in those years accounted for 11½ percent of real private GNP, whereas in 1966 the ratio was more than 12 percent. These ratios are shown in chart 1.

(Chart 1 follows:)

Chart 1

Real Nonresidential Fixed Investment Related to Real Private GNP



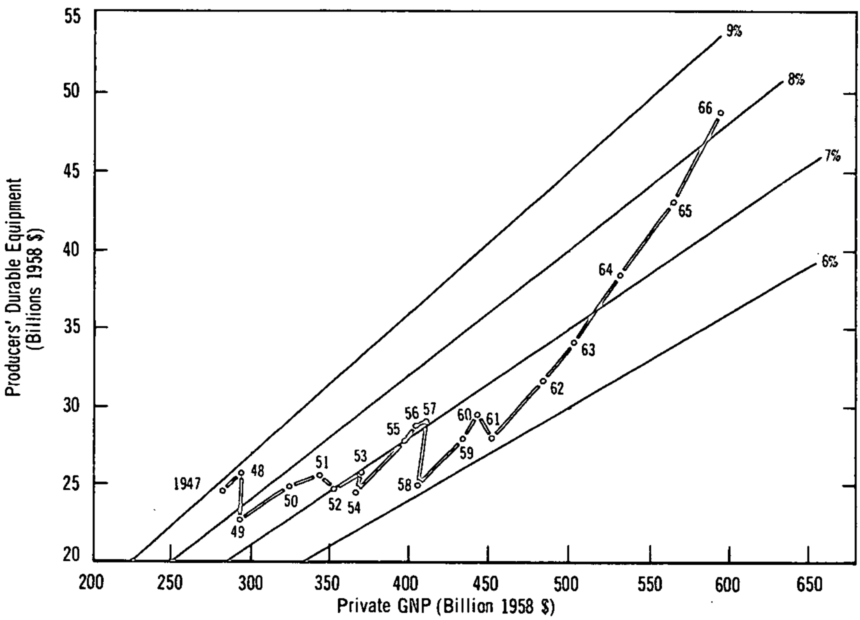
U.S. Department of Commerce, Office of Business Economics

The investment boom stemmed from the exceptionally strong demand for producers' durable equipment; investment in real nonresidential structures as a ratio to real private GNP in 1966 was lower than in 1956 and 1957 and about in line with most of the other postwar years. These are shown in chart 2.

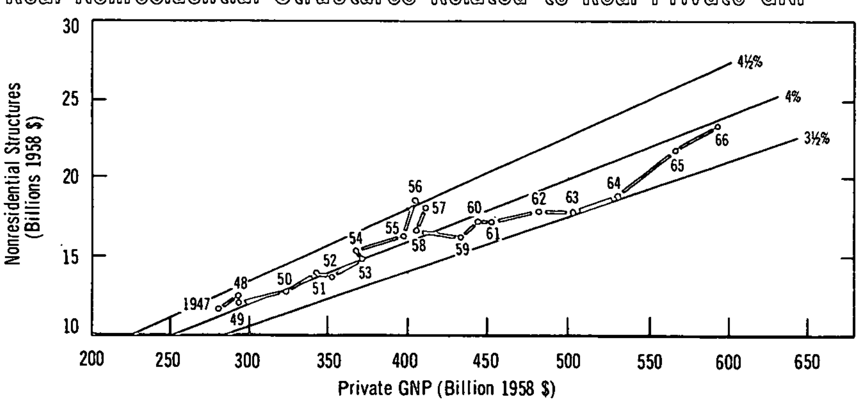
(Chart 2 follows:)

Chart 2

Real Producers' Durable Equipment Related to Real Private GNP



Real Nonresidential Structures Related to Real Private GNP



U.S. Department of Commerce, Office of Business Economics

The recent large expansion in capital goods demand has added substantially to our capacity to produce—manufacturing capacity, for example, increased 6 percent during 1965 and a further 7 percent last year. The investment surge was accompanied by much higher prices for machinery and equipment, by enlarged requirements for skilled labor, and by sizable accumulations of inventories.

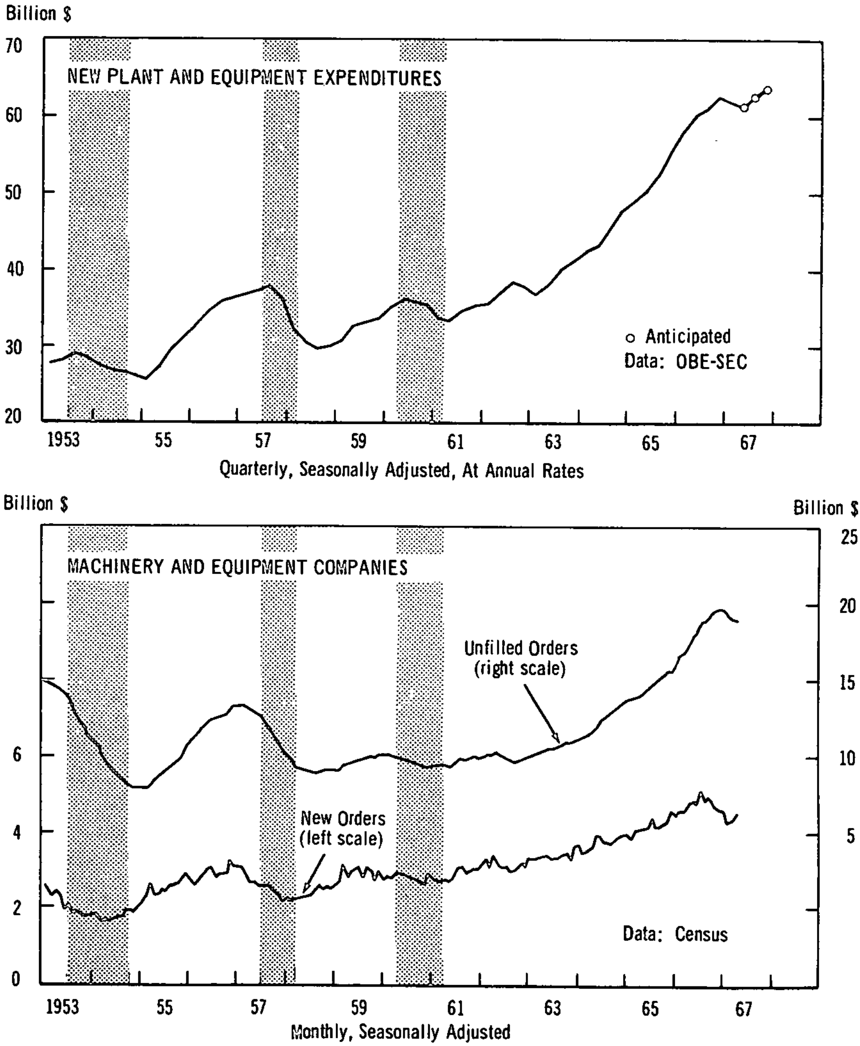
The capital goods expansion also contributed to the strains in money markets, as the internal funds generated by corporations were insufficient to finance their 1966 capital goods programs, and external sources of funds were resorted to more extensively than in the prior 5 years.

As the year progressed, it became clear that investment demand could not be sustained at such a fast pace without causing further strains on an economy operating at close to capacity. New orders received by machinery and equipment companies, which foreshadow capital expenditures, expanded sharply, particularly after September 1965, and reached a peak in July 1966. These are shown on chart 3. It was not possible at that time to predict that the uptrend would not continue.

(Chart 3 follows:)

Chart 3

New Plant and Equipment Expenditures and Orders of Machinery and Equipment Companies



U.S. Department of Commerce, Office of Business Economics

This was essentially the setting for the President's proposals last September to moderate the capital goods boom.

While the suspension of the investment tax credit and the use of accelerated depreciation on structures were elements in the subsequent cooling down of the capital goods expansion, there were other factors working in the same direction. I shall cite two important ones:

One, some of the major sources of private demand have been less buoyant since mid-1966. Retail sales have been on a virtual plateau since June a year ago; auto sales, in particular, have continued at lower rates than in the early months of 1966. Housing starts, which had declined to exceptionally low rates last October and November, have continued to be weak compared with the first half of 1966, although preliminary figures for May show a good rise over April.

Two, corporate profits after taxes, which had risen in the fourth quarter of 1965 and in the first quarter of 1966, weakened during the second half of the year, and then turned down sharply in the first quarter of 1967. The trend of profits is an important consideration by corporations in making their investment decisions concerning the period ahead.

As capacity expanded and the intensity of many sources of demand waned, the rate of manufacturing operation declined—from 19 percent of capacity in the third quarter of 1966 to 87 percent in the first quarter of this year (FRB basis). This was also a basic development which influenced businessmen to revise downward their earlier investment programs and to scale down sharply their projected increases in capital outlays for 1967. In view of the swift cooling off of the investment boom, an early restoration of the investment tax incentives to help bolster such demand was indicated.

This is, briefly, the background for considering the outlook for fixed nonresidential investment in the near term.

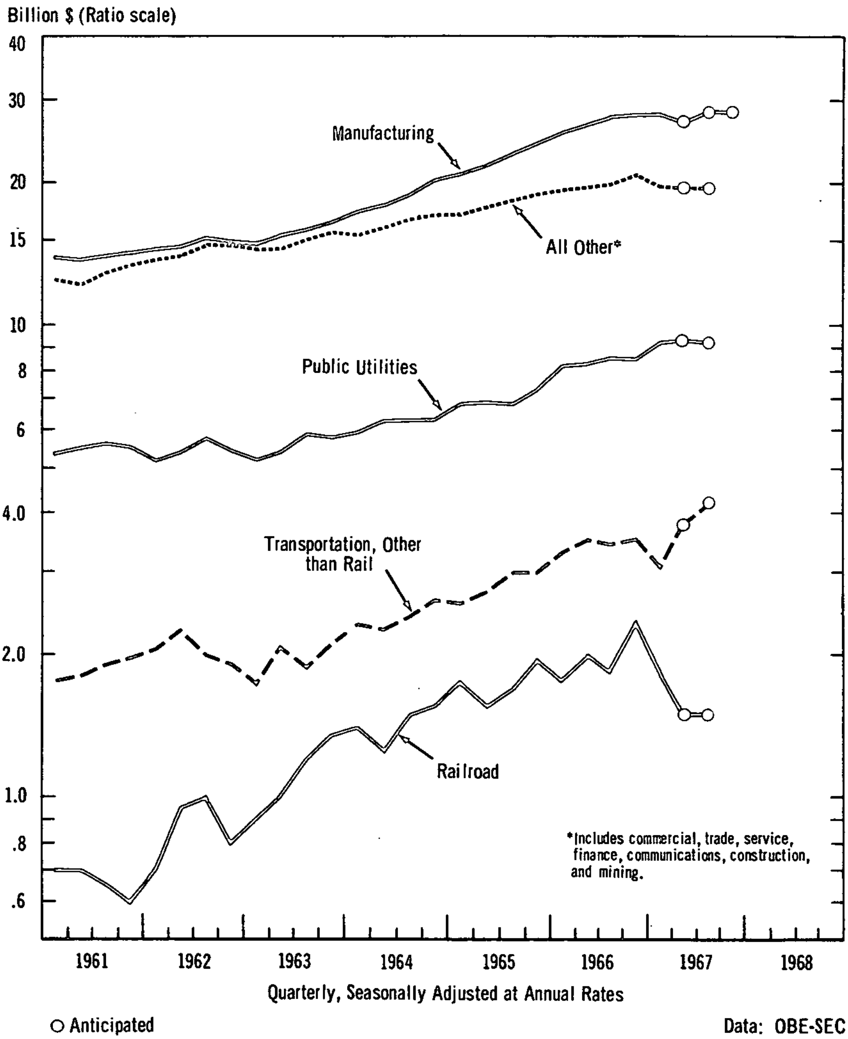
According to a report issued earlier this month, based on the survey of plant and equipment expenditure programs conducted in late April and May by the Department of Commerce and the Securities and Exchange Commission, businessmen anticipate only a 3-percent rise in their 1967 capital outlays over 1966; this compares with a 16½-percent increase last year.

The pattern of anticipations during the quarters of 1967 is shaped saucerlike; i.e., the actual decline of almost $1¼ billion (at annual rate, seasonally adjusted) in the first quarter of 1967 is expected to be followed by a further small drop in the current quarter, an increase of $1¼ billion in the third quarter, and another rise of $¾ billion in the fourth quarter. All major industries are anticipating smaller increases in 1967 than in 1966 with the exception of railroad companies, which report a sizable decline. (See chart 4.)

(Chart 4 follows:)

Chart 4

Expenditures for New Plant and Equipment by Major Industries



U.S. Department of Commerce, Office of Business Economics

Whether even the small 3-percent rise in total capital outlays now anticipated in 1967 will be realized is still open to question. Only 3 months ago businessmen anticipated a 4-percent increase. The restoration of the investment tax credit by the Congress should help to some extent, although we cannot tell how much.

The modest rise in anticipated capital outlays in the second half of this year is supported by recent increases in new orders received by machinery and equipment companies. From February to April of this year, these orders rose 6 percent, in contrast to the declining trend in the preceding 7 months.

I might say that in May there was also another good increase in these orders.

My judgment on the outlook for plant and equipment expenditures, based on the foregoing considerations, is as follows:

1. I expect that the increase in capital outlays in 1967 will be relatively small—perhaps even less than the 3 percent indicated by the recent Government survey. Expansion is being limited by the lower corporate profits expected this year compared with 1966, declining rates of capacity utilization, and other factors.

2. The modest increase in capital outlays anticipated in the second half of this year implies that real fixed capital goods demand will contribute little to a rise in real GNP, since most, if not all, of the projected increase in dollar outlays would reflect higher prices of capital goods.

3. On the basis of the large backlogs of unfilled orders still held by machinery and equipment companies—in April they were nearly 10 percent higher than a year ago—and a hopeful improvement in profits later this year, a further rise in capital outlays might occur in the first half of 1968, although a substantial increase in total demand would be necessary to justify a sizable capital goods expansion at that time. In view of the large increases in labor and other costs, which are developing this year, the emphasis of the 1968 capital programs may well be on cost-reducing facilities rather than on those designed to expand capacity.

Inventory Position and Prospects

Let us now turn to the inventory picture. First, I shall consider briefly the probable size of the inventory "excess" relative to sales, the areas in which it has occurred, and what progress, if any, has been made by business firms to adjust their inventories. Second, recognizing that forecasting inventory movements involves an element of judgment, I shall set forth some factors to consider as guides to their near-term course.

From 1961 to early 1966, inventory changes were closely geared with variations in sales and incoming orders. But after the first quarter of 1966, inventory accumulation greatly outstripped the sales performance so that inventory-sales ratios for most industries rose sharply. A major factor in this development was the failure of sales to materialize in accordance with producers' expectations during this period.

For example, last August manufacturers expected their sales to increase 5 percent from the second to the fourth quarter. The actual rise was only 2 percent. Another shortfall from anticipated sales occurred in the first quarter of this year.

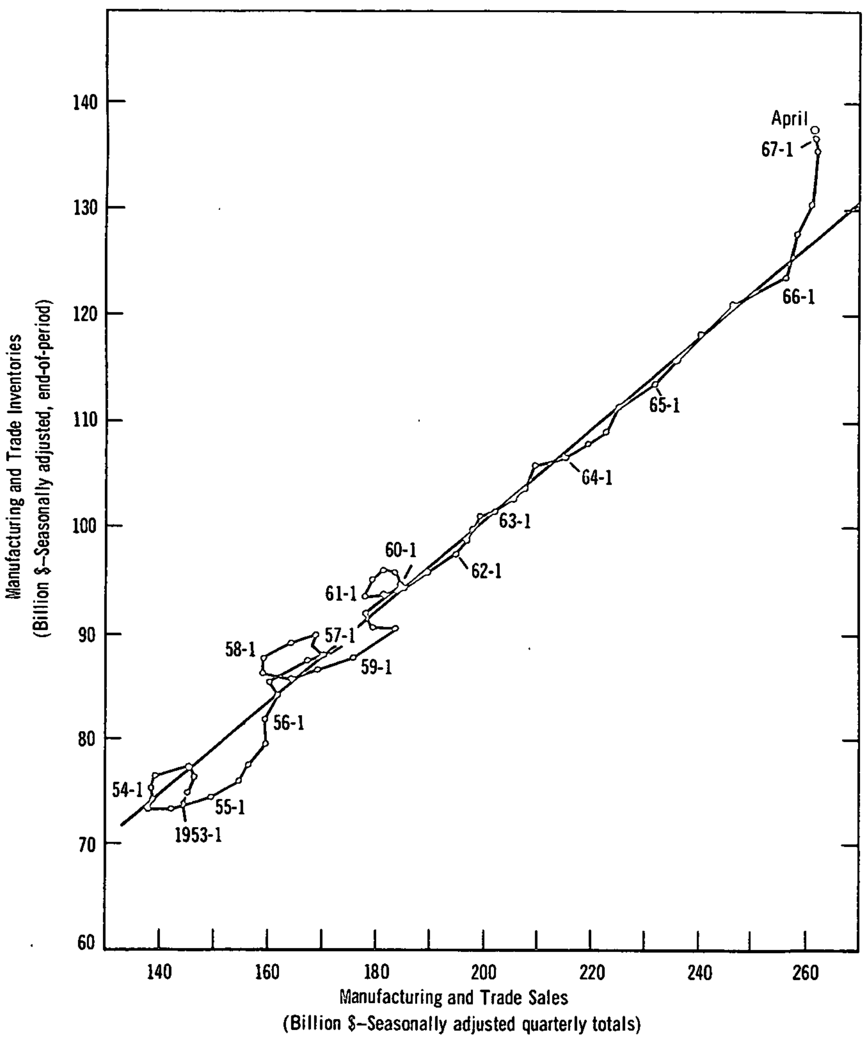
During the first 4 months of 1967, businessmen attempted to adjust their inventories and sharply reduce the rate of accumulation. Even so, because of dampened sales, the inventory position of a number of industries did not improve. The process of adjusting inventories is often circular—lower inventory demand reduces production and sales, and, unless other demands pick up, there is the need for further inventory correction.

Just how large is the inventory overhang? There are a number of possible approaches by which it can be estimated. I have used a linear relation between the end-of-quarter business inventories (book value for manufacturing and trade firms) and sales during the quarter. Chart 5 indicates this type of relation.

(Chart 5 follows:)

Chart 5

Manufacturing and Trade Inventories Related to Sales



U.S. Department of Commerce, Office of Business Economics

The line shown on the chart portrays the "norm" by which inventory and sales movements may be gaged, based on this type of relationship and the experience over the period 1953–65. If the point representing a particular quarter is appreciably above the line, inventories may be regarded as high relative to the corresponding sales; if the point is well below the line, the inventories may be viewed as low.

Over the years 1953–65 inventory changes were directly proportional to changes in sales except for significant departures in the recession periods and since the first quarter of last year. On the basis of this relation, total business inventories at the end of April 1967 were roughly $10 billion higher than they would have been if they had conformed with their relation to sales in prior years—a relationship using end-of-current-quarter inventories against the preceding quarter sales gives a slightly higher correlation and also shows a sizable inventory excess in April 1967. This is a large excess, representing approximately 7 percent over the "normal" level. An adjustment of the high inventories could take place without an actual liquidation, if sales were to increase substantially in the coming months.

As I shall indicate later, the inventory picture is mixed, and, therefore, the situation cannot be judged adequately by the use of global figures. It is necessary to examine inventory developments by categories.

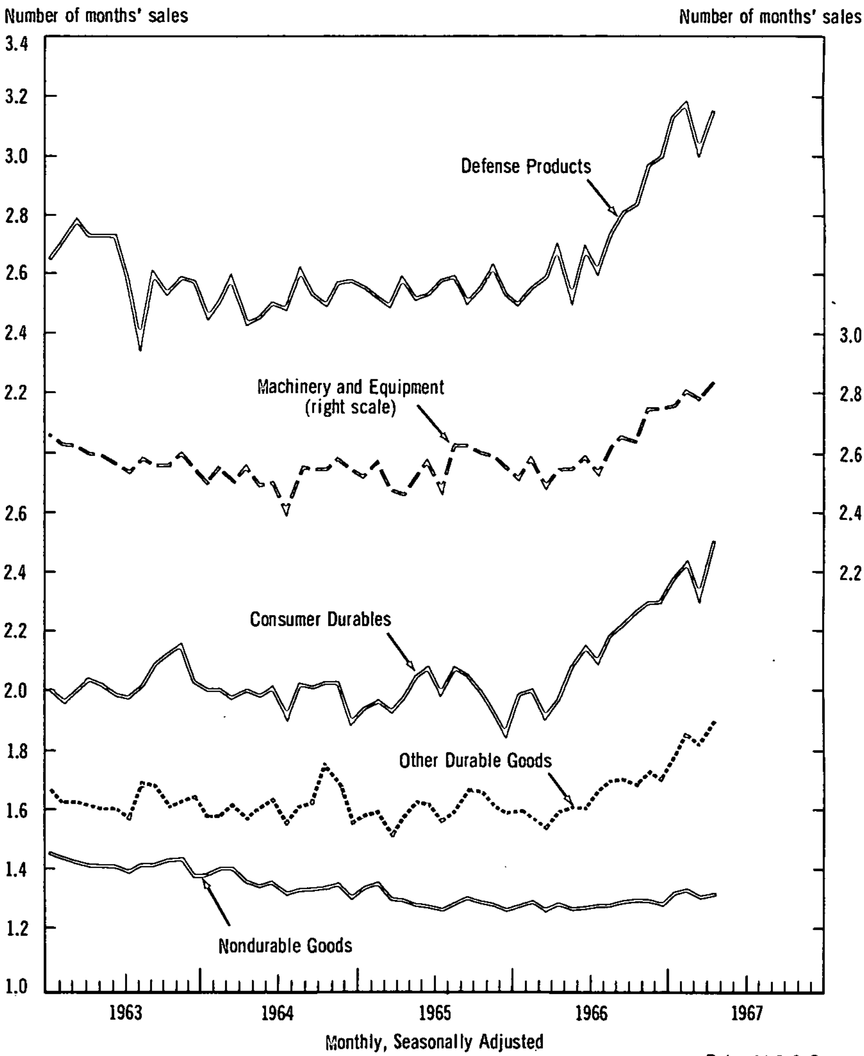
Inventory Position by Major Groups

Using a procedure similar to that described above for the total, I have analyzed inventory-sales relationships for selected manufacturing market categories, other manufacturing industries, and the major trade lines. I have also examined the inventory-sales ratios for these groups; they are depicted in charts 6 and 7. Both the inventory-sales ratios and the linear relations show that at the end of April inventories held by most groups were exceptionally high.

(Charts 6 and 7 follow:)

Chart 6

Manufacturing Inventory—Sales Ratios

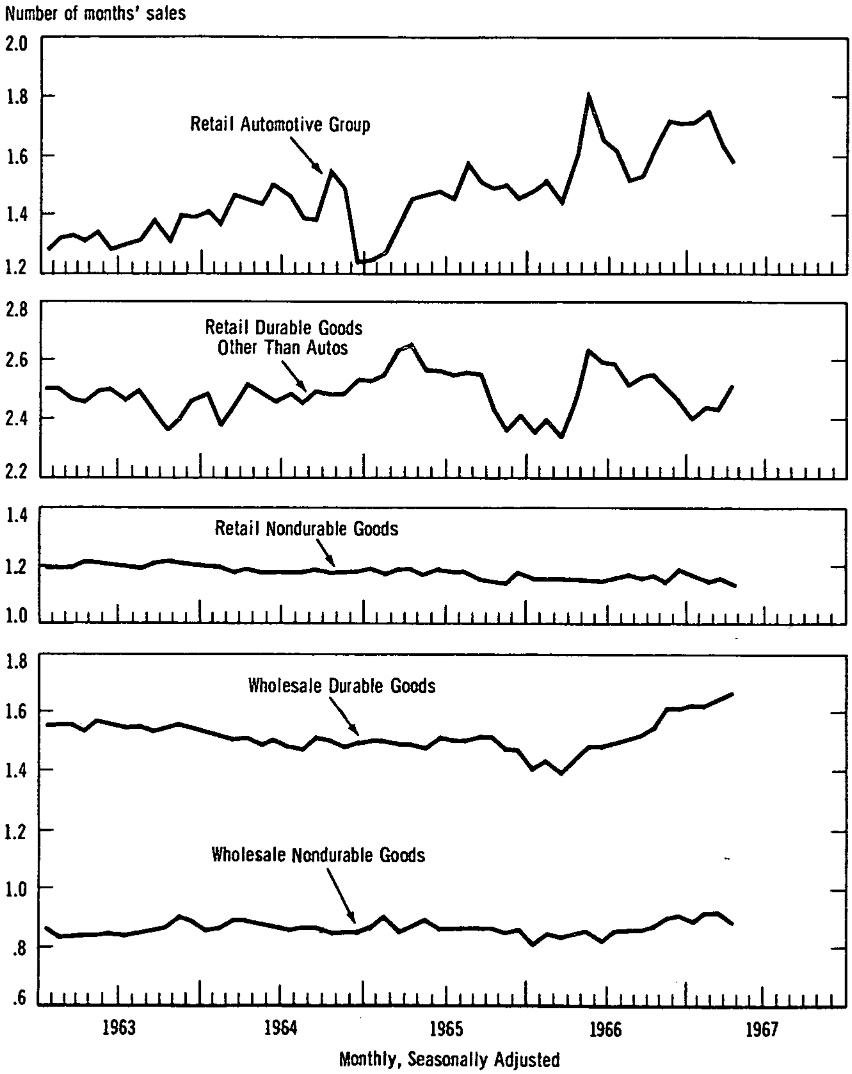


Data: OBE & Census

U.S. Department of Commerce, Office of Business Economics

Chart 7

Retail and Wholesale Trade Inventory—Sales Ratios



U.S. Department of Commerce, Office of Business Economics

Data: OBE & Census

Departures of actual inventory levels from the relationship values (the levels which would have been attained if inventories had maintained the same relation to sales as in the years prior to 1966) were calculated for December 1966 and April 1967, the period during which inventory investment was greatly reduced.

A number of observations may be made from this analysis:

One, the inventory position in relation to sales at the end of April 1967 deteriorated from that of last December in all major manufacturing groups despite the greatly reduced rate of accumulation over this period. Except for defense companies, the inventory increase was largely involuntary, stemming from lagging sales, which declined 3 percent from December 1966 to April 1967.

Two, companies producing defense products held an even larger "excess" of inventories in relation to sales in April 1967 than 4 months earlier, even though their shipments had risen during the period. The bulk of these inventories, however, consist of materials and supplies and work-in-process. They do not present a problem.

Three, inventories held by producers of machinery and equipment and of consumer durable goods (excluding automobiles) in April 1967 appear to be one-eighth too high. A good rise in the sales of these firms would help unclog their inventories, but, as I have already indicated, the former group is not anticipating large increases in sales this year, and consumer durable goods demand continues to lag. Thus, the completion of the inventory adjustment by these companies may require a considerable number of months.

Four, manufacturing industries comprising the "other durable goods" category—such as primary metals, fabricated metals, motor vehicles and parts, and stone, clay and glass products—had an "excess" inventory of nearly one-sixth of their total holdings in April 1967. The adjustment of these inventories also may not occur in just a few months, since the activity of these industries depends largely on orders placed for capital goods and consumer durables.

Five, the "excess" inventories held by nondurable goods producers in April 1967 were relatively small in relation to their total holdings, except in the case of the chemical and rubber industries, where April inventories were unusually high.

Six, retailers' inventories have been drawn down since December of last year. Auto stocks, which were recently large relative to sales, are being adjusted as sales improve, and these stocks present no problem. Inventories of other retail outlets in April 1967 were about right in the aggregate.

Seven, stocks held by wholesale merchants were somewhat high at the end of April 1967, especially in durable goods establishments and particularly in electrical goods.

Thus, it appears that the inventory problem centers in the "excess" inventories held by manufacturing durable goods companies (other than defense products) and by wholesale durable goods firms, amounting to one-seventh of their total holdings of $54 billion at the end of April.

Near-Term Prospects

The manufacturing inventory anticipations reported by the Department of Commerce earlier this month indicate that producers expect some further modest increases in inventories in this quarter and in the third. Apart from this report, there is little else available for gaging short-term inventory developments. Technicians have developed a variety of econometric equations; some of them at times have predicted well, and progress is being made in this area. Nevertheless, at the present time the use of relationships leaves much to be desired; they often break down just when a reliable guide is most needed.

Therefore, in forecasting inventories we must analyze all available relevant information and then use our best judgment to assess the likely prospects.

Viewing the demand forces as they are now shaping up in the public and private sectors, it appears that economic activity will gain momentum in the second half of this year. How much stronger the pace will be over the first half is still a question, and, on this point, there is a wide difference of opinion due to the varying assumptions made for the war expenditures, housing demand, consumer buying, and other factors. Assuming a stronger second half, the following points may be made with respect to the inventory situation and near-term prospects:

One, inventories held by durable goods producers and wholesalers are now rather high relative to their sales; on the other hand, most retail durable goods stocks and nondurable goods inventories at all levels appear to be about in line with sales.

Two, in the first quarter of this year, the total inventory accumulation amounted to $5½ billion (GNP basis, at annual rate). Judging from current production rates, surveys, and other evidence, the second quarter accumulation may be of the order of $2 billion, or even less. Inventories may show little change in the third quarter, and a moderate rise—$2 billion or more—in the fourth quarter.

I hold no brief for these numbers, although I feel they are in the right ball park. In view of the current large overhang of inventories, this pattern may appear to be quite optimistic. However, it should be pointed out that when the trend of sales is upward, which I am assuming for the months ahead, wholesalers' and manufacturers' orders will expand and a buildup of materials and supplies will occur. Excessive inventories under these circumstances would not be viewed so ominously as in periods when sales are sluggish.

The important point is that during the last three quarters of this year, shifts in inventory investment may be expected to have much less of an impact on the growth of output than was the case in the first quarter of this year. At that time, real GNP and industrial production dropped from the fourth quarter 1966 rates, mainly because of the $11 billion reduction in inventory investment.

Three, the foregoing pattern implies that inventory demand will not contribute much to a rise in real GNP in the second half of this year. However, this pattern could be materially altered if major strikes or threats of strikes should occur in any major industry.

Four, finally, because of a lag between inventories and sales, a stronger inventory demand may develop in the first half of 1968, if economic activity accelerates later this year.

Chairman PROXMIRE. Thank you, Mr. Paradiso. You certainly opened my eyes to a different view than we got yesterday and I think it was documented beautifully.

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(Tables submitted by Mr. Paradiso follow:)

TABLE 1.—*Real nonresidential fixed investment and GNP*

[In billions of 1958 dollars]

Year	Nonresidential fixed investment: Total	Producers' durable equipment	Nonresidential structures	Private GNP [1]	Total GNP
1947	36.2	24.6	11.6	281.4	309.9
1948	38.0	25.7	12.3	295.0	323.7
1949	34.5	22.6	11.9	294.1	324.1
1950	37.5	24.8	12.7	324.2	355.3
1951	39.6	25.5	14.1	344.6	383.4
1952	38.3	24.6	13.7	353.2	395.1
1953	40.7	25.8	14.9	371.1	412.8
1954	39.6	24.5	15.2	366.2	407.0
1955	43.9	27.7	16.2	397.2	438.0
1956	47.3	28.8	18.5	404.8	446.1
1957	47.4	29.1	18.2	410.5	452.5
1958	41.6	25.0	16.6	405.2	447.3
1959	44.1	27.9	16.2	433.4	475.9
1960	47.1	29.6	17.4	444.0	487.7
1961	45.5	28.1	17.4	452.3	497.2
1962	49.7	31.7	17.9	482.9	529.8
1963	51.9	34.0	17.9	503.2	551.0
1964	57.4	38.5	18.9	530.8	580.0
1965	64.9	43.2	21.7	563.5	614.4
1966	72.1	48.7	23.4	593.6	647.8

[1] Total GNP excluding compensation of Government employees.

Source: U.S. Department of Commerce, Office of Business Economics.

TABLE 2.—*Real nonresidential fixed investment: Ratio [1] to real GNP*

[In percent]

Year	Ratio to total GNP: Total nonresidential fixed investment	Ratio to total GNP: Producers' durable equipment	Ratio to total GNP: Nonresidential structures	Ratio to private GNP [2]: Total nonresidential fixed investment	Ratio to private GNP [2]: Producers' durable equipment	Ratio to private GNP [2]: Nonresidential structures
1947	11.7	7.9	3.7	12.9	8.7	4.1
1948	11.7	7.9	3.8	12.9	8.7	4.2
1949	10.6	7.0	3.7	11.7	7.7	4.0
1950	10.6	7.0	3.6	11.6	7.6	3.9
1951	10.3	6.7	3.7	11.5	7.4	4.1
1952	9.7	6.2	3.5	10.8	7.0	3.9
1953	9.9	6.2	3.6	11.0	7.0	4.0
1954	9.7	6.0	3.7	10.8	6.7	4.2
1955	10.0	6.3	3.7	11.1	7.0	4.1
1956	10.6	6.5	4.1	11.7	7.1	4.6
1957	10.5	6.4	4.0	11.5	7.1	4.4
1958	9.3	5.6	3.7	10.3	6.2	4.1
1959	9.3	5.9	3.4	10.2	6.4	3.7
1960	9.7	6.1	3.6	10.6	6.7	3.9
1961	9.2	5.7	3.5	10.1	6.2	3.8
1962	9.4	6.0	3.4	10.3	6.6	3.7
1963	9.4	6.2	3.2	10.3	6.8	3.6
1964	9.9	6.6	3.3	10.8	7.3	3.6
1965	10.6	7.0	3.5	11.5	7.7	3.9
1966	11.1	7.5	3.6	12.1	8.2	3.9

[1] Based on 1958 dollars.
[2] Excludes compensation of Government employees.

Source: U.S. Department of Commerce, Office of Business Economics.

TABLE 3.—*New plant and equipment expenditures and orders of machinery and equipment companies*

[In billions of dollars]

Year and month	New plant and equipment expenditures (OBE-SEC)[1]	Machinery and equipment[2]	
		Unfilled orders	New orders
1953—January		14.84	2.57
February	27.85	14.71	2.43
March		14.59	2.29
April		14.48	2.41
May	28.10	14.34	2.30
June		13.87	1.90
July		13.50	2.09
August	28.80	13.05	1.84
September		12.69	1.88
October		12.19	1.80
November	28.55	11.82	1.78
December		11.33	1.76
1954—January		10.85	1.78
Febraury	27.45	10.51	1.86
March		9.95	1.56
April		9.51	1.65
May	26.90	9.11	1.61
June		8.74	1.65
July		8.49	1.75
August	26.85	8.22	1.74
September		8.15	1.94
October		8.14	1.93
November	26.20	7.94	1.83
December		7.81	1.95
1955—January		7.82	2.09
February	25.65	7.93	2.29
March		8.27	2.62
April		8.39	2.30
May	27.20	8.43	2.31
June		8.68	2.47
July		8.96	2.43
August	29.65	9.23	2.59
September		9.46	2.57
October		9.78	2.64
November	31.45	10.17	2.77
December		10.68	2.87
1956—January		11.02	2.72
February	32.80	11.21	2.55
March		11.46	2.68
April		11.72	2.82
May	34.50	12.04	2.99
June		12.33	3.02
July		12.44	2.77
August	35.85	12.52	2.84
September		12.66	2.84
October		12.77	2.88
November	36.45	13.01	3.21
December		13.14	3.07
1957—January		13.17	2.96
February	36.90	13.21	2.96
March		13.13	2.83
April		12.94	2.61
May	37.05	12.75	2.63
June		12.50	2.53
July		12.29	2.52
August	37.75	12.01	2.56
September		11.66	2.42
October		11.26	2.36
November	36.25	10.82	2.33
December		10.38	2.16
1958—January		10.04	2.28
February	32.40	9.74	2.16
March		9.39	2.21
April		9.22	2.25
May	30.30	9.06	2.26
June		8.92	2.28
July		8.79	2.29
August	29.60	8.79	2.46
September		8.85	2.56
October		8.89	2.48
November	29.95	8.99	2.58
December		8.98	2.47
1959—January		9.00	2.62
February	30.60	9.03	2.70
March		9.35	3.06
April		9.41	2.79
May	32.50	9.50	2.92
June		9.66	3.00
July		9.76	3.03
August	33.35	9.75	2.79
September		9.87	3.04
October		9.96	2.93
November	33.60	9.94	2.74
December		10.04	2.96
1960—January		10.01	2.78
February	35.15	10.01	2.83
March		9.90	2.78
April		9.88	2.90
May	36.30	9.83	2.89
June		9.76	2.87
July		9.59	2.78
August	35.90	9.61	2.78
September		9.50	2.75
October		9.42	2.69
November	35.50	9.32	2.60
December		9.39	2.86
1961—January		9.41	2.76
February	33.85	9.38	2.74
March		9.41	2.71
April		9.41	2.74
May	33.50	9.40	2.70
June		9.38	2.80
July		9.64	3.03
August	34.70	9.85	3.07
September		9.84	2.88
October		9.86	2.91
November	35.40	9.93	2.98
December		9.84	2.96
1962—January		10.00	3.15
February	35.70	10.24	3.30
March		10.14	2.97
April		10.26	3.31
May	36.95	10.18	3.10
June		9.97	3.02
July		9.90	3.07
August	38.35	9.71	2.94
September		9.61	2.98
October		9.60	3.05
November	37.95	9.74	3.16
December		9.83	3.07
1963—January		9.96	3.25
February	36.95	10.01	3.21
March		10.15	3.22
April		10.30	3.35
May	38.05	10.49	3.42
June		10.48	3.29
July		10.55	3.33
August	40.00	10.65	3.31
September		10.75	3.42
October		10.93	3.44
November	41.20	10.93	3.27
December		11.19	3.61
1964—January		11.33	3.62
February	42.55	11.35	3.41
March		11.44	3.46
April		11.62	3.61
May	43.50	11.93	3.93
June		12.35	3.92
July		12.44	3.77
August	46.65	12.70	3.77
September		12.81	3.69
October		12.95	3.79
November	47.75	13.18	3.88
December		13.37	3.92

See footnotes at end of table, p. 78.

TABLE 3.—*New plant and equipment expenditures and orders of machinery and equipment companies*—Continued

[In billions of dollars]

Year and month	New plant and equipment expenditures (OBE-SEC) [1]	Machinery and equipment [2]		Year and month	New plant and equipment expenditures (OBE-SEC) [1]	Machinery and equipment [2]	
		Unfilled orders	New orders			Unfilled orders	New orders
1965—January		13.53	3.96	1961—July		18.68	5.09
February	49.00	13.57	3.80	August	61.25	18.99	4.81
March		13.77	4.02	September		19.33	4.91
April		13.98	4.08	October		19.50	4.82
May	50.35	14.17	4.07	November	62.80	19.60	4.65
June		14.42	4.09	December		19.61	4.60
July		14.70	4.35	1967—January		19.54	4.54
August	52.75	14.98	4.16	February	61.65	19.22	4.24
September		15.15	4.15	March		18.91	4.32
October		15.37	4.25	April		[3] 18.85	[3] 4.48
November	55.35	15.61	4.32	May	[4] 61.55		
December		15.60	4.58	June			
1966—January		16.18	4.45	July			
February	58.00	16.58	4.58	August	[4] 62.80		
March		16.78	4.59	September			
April		17.27	4.79	October			
May	60.10	17.76	4.84	November	[4] 63.60		
June		18.14	4.75	December			

[1] Quarterly seasonally adjusted annual rate.
[2] Seasonally adjusted rate.
[3] Preliminary.
[4] Anticipated.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census; Securities and Exchange Commission.

TABLE 4.—*Expenditures for new plant and equipment by major industries*

[In billions of dollars, seasonally adjusted annual rates]

Year and quarter	Manufacturing	Public utilities	Transportation other than rail	Railroad	All other [1]
1961—1	13.75	5.35	1.75	.70	12.30
2	13.50	5.50	1.80	.70	12.05
3	13.65	5.65	1.90	.65	12.80
4	14.00	5.55	1.95	.60	13.35
1962—1	14.20	5.15	2.05	.70	13.60
2	14.45	5.40	2.25	.95	13.95
3	15.05	5.75	2.00	1.00	14.55
4	15.00	5.45	1.90	.80	14.80
1963—1	14.85	5.20	1.70	.90	14.25
2	15.30	5.45	2.05	1.00	14.30
3	15.95	5.90	1.85	1.20	15.10
4	16.45	5.80	2.10	1.35	15.55
1964—1	17.40	5.95	2.30	1.40	15.45
2	17.80	6.30	2.25	1.25	15.90
3	18.85	6.30	2.40	1.50	16.60
4	20.15	6.35	2.60	1.55	17.10
1965—1	20.75	6.80	2.55	1.75	17.10
2	21.55	6.85	2.70	1.55	17.70
3	23.00	6.75	3.00	1.70	18.25
4	24.15	7.30	3.00	1.95	18.90
1966—1	25.60	8.25	3.30	1.75	19.10
2	26.80	8.30	3.50	2.00	19.50
3	27.55	8.55	3.40	1.85	19.90
4	27.75	8.50	3.50	2.35	20.70
1967—1	27.85	9.20	3.05	1.80	19.70
2 [2]	27.30	9.25	3.80	1.50	19.65
3 [2]	28.35	9.20	4.20	1.50	19.60
4 [2]	28.15	(3)	(3)	(3)	(3)

[1] Includes commercial, trade, service, finance, communications, construction, and mining.
[2] Anticipated.
[3] Not available.

Source: U.S. Department of Commerce, Office of Business Economics; Securities and Exchange Commission.

TABLE 5.—*Manufacturing and trade inventories and sales*

[Billions of dollars, seasonally adjusted]

Year and quarter	Inventories (end of quarter)	Sales (quarterly total)	Year and quarter	Inventories (end of quarter)	Sales (quarterly total)
1953—1	74.6	145.1	1960—1	94.6	184.4
2	76.2	146.2	2	95.5	183.2
3	77.4	145.4	3	95.7	180.8
4	76.1	139.5	4	94.7	179.2
1954—1	75.1	138.6	1961—1	93.7	177.3
2	74.0	138.9	2	93.8	181.1
3	73.2	137.8	3	94.5	184.9
4	73.2	142.1	4	95.8	189.9
1955—1	74.5	149.9	1962—1	97.3	194.6
2	75.7	154.4	2	98.6	196.5
3	77.4	156.6	3	99.6	197.2
4	79.5	159.5	4	100.6	198.6
1956—1	81.8	159.2	1963—1	101.4	201.8
2	84.0	161.6	2	102.4	205.0
3	85.6	159.9	3	103.6	207.6
4	87.3	167.1	4	105.6	209.7
1957—1	88.2	170.2	1964—1	106.5	215.1
2	88.6	167.5	2	107.7	219.0
3	89.9	168.6	3	109.0	222.6
4	89.1	164.3	4	111.1	224.3
1958—1	87.6	158.8	1965—1	113.7	232.2
2	86.1	158.7	2	115.7	235.8
3	85.9	163.9	3	117.9	240.1
4	86.9	169.4	4	120.9	246.3
1959—1	87.9	175.8	1966—1	123.6	256.2
2	90.5	183.2	2	127.6	257.8
3	90.6	178.9	3	130.8	260.4
4	91.9	177.7	4	135.5	261.6
			1967: 1	137.1	261.1

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 6a.—*Inventory-sales ratios,*[1] *manufacturing and trade*

Year and month	Total manufacturing and trade	Manufacturing					
		Total manufacturing	Defense products	Machinery and equipment	Consumer durables	Other durables	Nondurable goods industries
1963							
January	1.51	1.73	2.65	2.66	2.00	1.67	1.45
February	1.50	1.70	2.71	2.63	1.97	1.63	1.43
March	1.50	1.70	2.78	2.62	2.00	1.63	1.42
April	1.49	1.69	2.72	2.60	2.04	1.61	1.41
May	1.50	1.68	2.72	2.58	2.02	1.60	1.41
June	1.49	1.68	2.73	2.56	1.98	1.60	1.41
July	1.47	1.65	2.59	2.53	1.97	1.57	1.39
August	1.50	1.70	2.34	2.57	2.02	1.69	1.41
September	1.50	1.70	2.61	2.55	2.09	1.68	1.41
October	1.49	1.68	2.53	2.55	2.14	1.61	1.43
November	1.52	1.71	2.58	2.60	2.16	1.63	1.44
December	1.49	1.67	2.57	2.54	2.03	1.65	1.37
1964							
January	1.47	1.64	2.45	2.50	2.00	1.58	1.37
February	1.48	1.66	2.51	2.55	2.00	1.58	1.40
March	1.49	1.67	2.60	2.51	1.98	1.61	1.40
April	1.47	1.63	2.43	2.55	2.00	1.57	1.36
May	1.47	1.63	2.45	2.49	1.98	1.61	1.34
June	1.48	1.64	2.51	2.50	2.01	1.63	1.35
July	1.45	1.59	2.47	2.38	1.91	1.57	1.32
August	1.46	1.63	2.62	2.54	2.02	1.61	1.33
September	1.47	1.64	2.52	2.53	2.01	1.62	1.33
October	1.49	1.68	2.49	2.53	2.03	1.76	1.33
November	1.48	1.66	2.56	2.57	2.03	1.68	1.34
December	1.44	1.60	2.57	2.53	1.89	1.56	1.31
1965							
January	1.46	1.63	2.55	2.52	1.95	1.58	1.34
February	1.47	1.64	2.52	2.57	1.97	1.59	1.35
March	1.44	1.58	2.49	2.47	1.93	1.52	1.30
April	1.46	1.60	2.58	2.46	1.97	1.57	1.29
May	1.46	1.61	2.52	2.51	2.05	1.63	1.28
June	1.47	1.62	2.53	2.57	2.09	1.62	1.28
July	1.44	1.58	2.57	2.46	1.98	1.55	1.26
August	1.48	1.62	2.58	2.63	2.08	1.59	1.29
September	1.48	1.65	2.50	2.63	2.06	1.67	1.30
October	1.47	1.64	2.54	2.60	2.00	1.66	1.29
November	1.45	1.62	2.63	2.59	1.94	1.62	1.28
December	1.45	1.60	2.52	2.56	1.86	1.59	1.27
1966							
January	1.43	1.61	2.50	2.51	1.99	1.60	1.28
February	1.45	1.62	2.55	2.58	2.00	1.58	1.29
March	1.42	1.58	2.59	2.48	1.91	1.54	1.26
April	1.46	1.62	2.68	2.54	1.97	1.59	1.28
May	1.48	1.61	2.51	2.54	2.07	1.61	1.27
June	1.47	1.63	2.68	2.59	2.14	1.61	1.27
July	1.48	1.65	2.60	2.53	2.09	1.67	1.28
August	1.49	1.68	2.72	2.62	2.18	1.70	1.28
September	1.51	1.70	2.81	2.65	2.23	1.71	1.29
October	1.52	1.70	2.84	2.63	2.26	1.69	1.30
November	1.54	1.73	2.96	2.74	2.30	1.73	1.30
December	1.54	1.71	3.00	2.74	2.30	1.70	1.28
1967							
January	1.56	1.77	3.13	2.76	2.38	1.79	1.32
February	1.58	1.81	3.17	2.81	2.44	1.85	1.33
March	1.57	1.78	3.00	2.77	2.30	1.83	1.31
April[2]	1.58	1.82	3.15	2.84	2.50	1.90	1.32

[1] Based on seasonally adjusted data. End-of-month inventories divided by sales for month.
[2] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 6b.—*Inventory-sales ratios,*[1] *manufacturing and trade*

Year and month	Merchant wholesalers			Retail trade			
	Total wholesale	Durable goods establishments	Nondurable goods establishments	Total retail	Automotive stores	Other durable goods stores	Nondurable goods stores
1963—January	1.17	1.55	0.87	1.38	1.28	2.50	1.19
February	1.14	1.55	.83	1.39	1.32	2.50	1.19
March	1.14	1.55	.84	1.39	1.33	2.47	1.19
April	1.13	1.53	.84	1.39	1.31	2.46	1.21
May	1.15	1.57	.84	1.40	1.34	2.49	1.21
June	1.15	1.56	.85	1.39	1.28	2.50	1.20
July	1.13	1.54	.84	1.39	1.30	2.47	1.20
August	1.15	1.55	.85	1.39	1.32	2.49	1.19
September	1.15	1.53	.86	1.40	1.38	2.42	1.21
October	1.16	1.54	.87	1.39	1.30	2.37	1.22
November	1.18	1.56	.90	1.41	1.40	2.40	1.21
December	1.16	1.54	.88	1.40	1.39	2.46	1.20
1964—January	1.15	1.53	.86	1.41	1.41	2.48	1.20
February	1.15	1.52	.87	1.40	1.36	2.38	1.20
March	1.15	1.50	.89	1.41	1.47	2.44	1.18
April	1.16	1.51	.89	1.41	1.45	2.52	1.19
May	1.14	1.48	.88	1.41	1.43	2.48	1.18
June	1.14	1.50	.87	1.41	1.50	2.45	1.18
July	1.13	1.48	.86	1.41	1.47	2.48	1.18
August	1.13	1.47	.87	1.39	1.38	2.45	1.18
September	1.14	1.51	.87	1.40	1.38	2.49	1.19
October	1.13	1.50	.85	1.42	1.56	2.48	1.18
November	1.13	1.48	.85	1.41	1.49	2.48	1.18
December	1.13	1.49	.85	1.37	1.23	2.53	1.18
1965—January	1.15	1.50	.87	1.38	1.25	2.53	1.19
February	1.17	1.50	.90	1.37	1.27	2.55	1.17
March	1.13	1.49	.85	1.42	1.38	2.63	1.19
April	1.14	1.49	.87	1.43	1.45	2.65	1.19
May	1.15	1.48	.89	1.41	1.47	2.57	1.17
June	1.15	1.51	.87	1.43	1.48	2.57	1.19
July	1.14	1.50	.87	1.41	1.45	2.55	1.18
August	1.15	1.50	.87	1.44	1.58	2.56	1.18
September	1.15	1.51	.87	1.41	1.51	2.55	1.16
October	1.15	1.51	.87	1.38	1.49	2.42	1.15
November	1.12	1.47	.85	1.38	1.50	2.36	1.14
December	1.13	1.47	.86	1.40	1.46	2.41	1.18
1966—January	1.07	1.40	.81	1.39	1.48	2.35	1.16
February	1.11	1.43	.84	1.39	1.52	2.40	1.16
March	1.09	1.39	.83	1.37	1.43	2.34	1.16
April	1.12	1.45	.84	1.42	1.61	2.47	1.16
May	1.13	1.48	.85	1.47	1.81	2.63	1.16
June	1.11	1.48	.82	1.43	1.66	2.59	1.15
July	1.14	1.49	.86	1.43	1.62	2.58	1.16
August	1.15	1.50	.86	1.42	1.52	2.51	1.17
September	1.15	1.52	.86	1.41	1.53	2.54	1.16
October	1.17	1.55	.87	1.44	1.62	2.55	1.17
November	1.21	1.61	.90	1.43	1.72	2.49	1.15
December	1.22	1.61	.91	1.46	1.71	2.47	1.19
1967—January	1.21	1.62	.89	1.44	1.71	2.40	1.17
February	1.23	1.62	.92	1.44	1.75	2.43	1.15
March	1.24	1.65	.92	1.42	1.63	2.43	1.16
April [2]	1.22	1.67	.88	1.40	1.58	2.51	1.14

[1] Based on seasonally adjusted data. End-of-month inventories divided by sales for month.
[2] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 7a.—*Manufacturing and trade inventories* [1]

[In billions of dollars, seasonally adjusted]

Year and month	Total manufacturing and trade	Manufacturing					
		Total manufacturing	Defense products	Machinery and equipment	Consumer durables	Other durables	Nondurable goods industries
1965—January	112.10	63.21	5.60	9.44	3.07	20.37	24.72
February	112.42	63.38	5.61	9.54	3.08	20.46	24.69
March	113.66	63.71	5.69	9.56	3.13	20.59	24.74
April	114.39	64.00	5.79	9.62	3.16	20.66	24.77
May	115.09	64.27	5.74	9.65	3.21	20.87	24.79
June	115.74	64.62	5.81	9.86	3.24	21.03	24.67
July	116.70	65.39	5.97	10.01	3.25	21.38	24.79
August	117.71	65.79	6.03	10.22	3.25	21.32	24.97
September	117.91	66.27	6.04	10.43	3.22	21.60	24.97
October	118.43	66.64	6.09	10.49	3.23	21.71	25.12
November	119.28	67.19	6.27	10.59	3.25	21.75	25.32
December	120.90	68.02	6.39	10.70	3.29	21.95	25.69
1966—January	121.57	68.59	6.52	10.74	3.38	21.95	26.00
February	122.54	69.04	6.58	10.82	3.42	22.06	26.16
March	123.63	69.65	6.82	10.85	3.48	22.13	26.38
April	124.70	70.35	7.08	10.94	3.51	22.25	26.57
May	126.18	71.10	7.10	11.06	3.63	22.49	26.83
June	127.58	71.95	7.30	11.34	3.72	22.64	26.95
July	128.71	72.96	7.51	11.54	3.76	22.97	27.17
August	130.04	74.11	7.74	11.82	3.83	23.43	27.30
September	130.84	74.88	7.92	12.10	3.92	23.62	27.32
October	132.39	75.79	8.19	12.23	4.04	23.90	27.44
November	133.86	76.90	8.46	12.47	4.15	24.23	27.59
December	135.55	77.90	8.73	12.59	4.19	24.52	27.86
1967—January	136.59	78.89	8.99	12.72	4.31	24.60	28.27
February	136.78	79.39	9.19	12.80	4.33	24.76	28.32
March	137.09	79.71	9.40	12.83	4.29	24.70	28.49
April [2]	137.19	80.32	9.61	12.89	4.25	24.87	28.71

[1] Book value, end of period. [2] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 7b.—*Manufacturing and trade inventories* [1]

[In billions of dollars, seasonally adjusted]

Year and month	Merchant wholesalers			Retail trade			
	Total wholesale	Durable goods establishments	Nondurable goods estabishments	Total retail	Automotive stores	Other durable goods stores	Nondurable durable goods stores
1965—January	17.27	10.00	7.27	31.61	5.90	7.67	18.05
February	17.37	10.04	7.33	31.67	5.96	7.74	17.97
March	17.57	10.14	7.44	32.38	6.36	7.81	18·20
April	17.67	10.11	7.56	32.72	6.51	7.90	18.32
May	17.88	10.24	7.64	32.94	6.72	7.87	18.36
June	17.87	10.25	7.63	33.24	6.81	7.86	18.58
July	17.91	10.32	7.58	33.40	6.89	7.88	18.62
August	17.93	10.34	7.59	33.99	7.38	7.91	18.69
September	18.06	10.43	7.63	33.58	7.04	7.93	18.61
October	18.12	10.46	7.67	33.67	7.06	7.87	18.74
November	18.17	10.52	7.65	33.92	7.15	7.83	18.94
December	18.27	10.58	7.70	34.61	7.24	7.95	19.41
1966—January	18.23	10.57	7.66	34.74	7.23	8.10	19.42
February	18.58	10.81	7.77	34.92	7.25	8.17	19.50
March	18.88	11.00	7.89	35.10	7.31	8.24	19.55
April	19.01	11.21	7.80	35.35	7.39	8.30	19.66
May	19.15	11.24	7.91	35.93	7.76	8.46	19.71
June	19.31	11.32	7.99	36.32	7.91	8.50	19.91
July	19.44	11.35	8.10	36.31	7.70	8.63	19.98
August	19.74	11.58	8.16	36.19	7.54	8.54	20.11
September	19.60	11.44	8.16	36.36	7.72	8.52	20.11
October	19.92	11.72	8.20	36.68	7.95	8.55	20.18
November	20.23	11.84	8.39	36.73	8.17	8.41	20.15
December	20.69	12.11	8.58	36.96	8.11	8.43	20.42
1967—January	20.78	12.14	8.64	36.92	7.87	8.62	20.43
February	20.74	12.10	8.65	36.64	7.67	8.64	20.33
March	20.86	12.10	8.75	36.53	7.52	8.63	20.38
April [2]	20.63	12.04	8.59	36.24	7.41	8.62	20.20

[1] Book value, end of period. [2] Preliminary.

Source: U.S. Department of Commerce.

TABLE 8a.—*Manufacturing and trade sales*

[In billions of dollars; seasonally adjusted]

Year and month	Total manufacturing and trade	Manufacturing			Consumer durables	Other durables	Nondurable goods industries
		Total manufacturing	Defense products	Machinery and equipment			
1965							
January	76.87	38.88	2.20	3.76	1.57	12.89	18.47
February	76.56	38.69	2.22	3.71	1.57	12.88	18.32
March	78.73	40.28	2.28	3.87	1.62	13.51	19.00
April	78.33	40.04	2.26	3.87	1.59	13.19	19.13
May	78.64	39.81	2.28	3.85	1.57	12.82	19.30
June	78.80	39.94	2.30	3.84	1.55	12.96	19.29
July	80.78	41.45	2.32	4.07	1.64	13.78	19.63
August	79.68	40.52	2.34	3.88	1.56	13.41	19.33
September	79.61	40.17	2.42	3.98	1.57	12.96	19.25
October	80.66	40.55	2.40	4.04	1.62	13.09	19.40
November	82.21	41.40	2.38	4.09	1.67	13.46	19.80
December	83.48	42.62	2.53	4.19	1.77	13.83	20.31
1966							
January	84.73	42.66	2.60	4.27	1.70	13.73	20.36
February	84.53	42.70	2.58	4.19	1.71	13.95	20.27
March	86.99	44.12	2.64	4.38	1.82	14.41	20.88
April	85.46	43.54	2.64	4.30	1.78	13.98	20.83
May	85.43	44.07	2.83	4.35	1.75	13.98	21.16
June	86.96	44.12	2.73	4.38	1.74	14.06	21.23
July	86.68	44.33	2.89	4.55	1.80	13.78	21.30
August	87.00	44.21	2.85	4.51	1.76	13.76	21.33
September	86.78	44.09	2.82	4.56	1.76	13.83	21.12
October	87.07	44.49	2.89	4.65	1.79	14.13	21.04
November	86.70	44.39	2.86	4.55	1.80	14.02	21.16
December	87.88	45.51	2.91	4.59	1.82	14.40	21.80
1967							
January	87.39	44.46	2.88	4.62	1.81	13.76	21.40
February	86.30	43.93	2.90	4.56	1.78	13.39	21.31
March	87.46	44.87	3.14	4.63	1.86	13.51	21.73
April [1]	86.95	44.10	3.05	4.53	1.70	13.06	21.75

[1] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 8b.—*Manufacturing and trade sales*

[In billions of dollars, seasonally adjusted]

Year and month	Merchant wholesalers			Retail trade			
	Total wholesale	Durable goods establishments	Nondurable goods establishments	Total retail	Automotive stores	Other durable goods stores	Nondurable goods stores
1965							
January	15.05	6.68	8.36	22.94	4.73	3.03	15.18
February	14.79	6.67	8.12	23.08	4.69	3.03	15.35
March	15.59	6.81	8.78	22.86	4.61	2.97	15.28
April	15.44	6.79	8.64	22.85	4.47	2.98	15.40
May	15.51	6.90	8.61	23.32	4.56	3.06	15.70
June	15.54	6.79	8.75	23.32	4.61	3.06	15.66
July	15.66	6.90	8.76	23.67	4.74	3.08	15.84
August	15.58	6.91	8.68	23.58	4.66	3.10	15.83
September	15.68	6.91	8.77	23.75	4.66	3.11	15.98
October	15.78	6.95	8.83	24.33	4.75	3.25	16.33
November	16.16	7.15	9.02	24.65	4.78	3.32	16.56
December	16.15	7.17	8.98	24.70	4.95	3.30	16.45
1966							
January	16.98	7.56	9.42	25.08	4.88	3.44	16.76
February	16.78	7.54	9.24	25.05	4.78	3.40	16.86
March	17.33	7.89	9.45	25.54	5.12	3.53	16.89
April	16.97	7.72	9.25	24.95	4.58	3.36	17.01
May	16.88	7.60	9.28	24.48	4.29	3.22	16.97
June	17.44	7.64	9.80	25.39	4.77	3.28	17.34
July	16.99	7.61	9.38	25.36	4.76	3.34	17.26
August	17.22	7.74	9.48	25.57	4.96	3.40	17.21
September	16.98	7.51	9.47	25.70	5.03	3.36	17.31
October	17.03	7.57	9.46	25.55	4.92	3.36	17.27
November	16.70	7.37	9.32	25.61	4.76	3.38	17.47
December	17.00	7.50	9.46	25.37	4.74	3.41	17.21
1967							
January	17.24	7.50	9.74	25.69	4.60	3.60	17.49
February	16.90	7.49	9.41	25.47	4.39	3.56	17.52
March	16.85	7.35	9.50	25.74	4.60	3.55	17.59
April [1]	16.93	7.22	9.72	25.92	4.70	3.43	17.79

[1] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics and Bureau of the Census.

TABLE 9.—*Change in business inventories (GNP basis)*

[Billions of dollars, seasonally adjusted annual rates]

Year and quarter	Total business	Manufacturing			Retail trade			Wholesale trade			All other [1]
		Total	Durable	Nondurable	Total	Durable	Nondurable	Total	Durable	Nondurable	
1964—1	3.5	0.1	−0.4	0.5	2.1	2.1	(2)	0.9	0.1	0.8	0.4
2	4.2	.2	1.2	−1.0	2.8	.9	1.9	1.4	.9	.5	−.2
3	3.6	2.8	2.1	.8	.2	−.2	.4	1.1	.5	.5	−.5
4	7.4	7.1	5.1	2.0	−.6	−1.7	1.1	1.2	.8	.4	−.3
1965—1	9.5	2.4	2.0	.4	4.2	3.6	.6	2.3	1.2	1.1	.6
2	7.6	3.1	3.7	.7	2.1	1.7	.3	1.0	.4	.7	1.4
3	8.7	5.9	4.6	1.3	−.2	.2	−.4	1.1	1.4	−.3	1.9
4	10.4	5.4	3.0	2.4	2.6	.5	2.0	.6	.8	−.1	1.8
1966—1	8.9	4.7	2.8	1.9	1.5	1.5	.1	1.8	1.1	.7	.9
2	12.3	8.0	6.0	2.0	3.5	2.4	1.2	.4	.5	−.1	.4
3	9.9	9.6	9.0	.6	−.7	−.6	(2)	.9	.5	.4	.1
4	16.4	11.7	8.9	2.7	2.3	.7	1.7	3.2	1.8	1.4	−.8
1967—1	5.6	7.0	3.7	3.3	−2.3	−1.8	−.4	.8	.5	.3	.1

[1] Including farm.
[2] Less than $50,000,000.

Source: U.S. Department of Commerce, Office of Business Economics.

Chairman PROXMIRE. Mr. Sumichrast?

STATEMENT OF MICHAEL SUMICHRAST, DIRECTOR OF ECONOMICS, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. SUMICHRAST. Mr. Chairman and members of the Joint Economic Committee, it is my distinct pleasure to be here today. I have with me my two associates, Mr. Norman Farquhar and Mr. Charles P. McMahon.

The homebuilding industry plays a vital role in the American economy. It can generate annually more than $21 billion in direct expenditures for new privately owned single and multifamily units.

Following World War II the industry succeeded in rapidly expanding production to satisfy pent-up demand resulting from the war and depression.

During 1950, production exceeded the 1.9 million unit mark—a level which has not been duplicated since. Our industry, as you very well know, has been plagued by the uncertainty of the money markets which generated declines in 1951, 1956–57, 1959–60, and the latest in 1966.

From an annual rate of 1,611,000 units in January of 1966, housing production begain dropping, dipping to a postwar low rate, a 25-year low, of 848,000 units in October 1966. A recovery began in early 1957, but it was slow and failed to hold out much hope to those looking to our industry to partially counter some of the sluggishness in the other sectors of the economy.

During the first 5 months of 1967, a weighted average of the seasonally adjusted annual rates of production indicates that we have not exceeded the 1966 level of production. In fact, actual starts for the first 5 months are 100,000 behind activity for the same period of 1966.

The remaining 7 months of 1967 hold little hope for recovery of last year's losses. A special preliminary tabulation of 75 major metropolitan areas—the largest areas covered by NAHB's metropolitan forecast which now reports on in excess of 100 areas—covered by NAHB's quarterly forecast program shows an expected gain of 4 percent in singles, partially offset by a loss of 3 percent in multiple starts. For the year as a whole the metropolitan forecast indicates approximately 820,000 single-family units will be started and 415,000 multiples.

This is not much change from the production we have achieved last year.

The latest forecast is somewhat more optimistic than the view of the same markets in mid-March but still points to a continued low level for our industry.

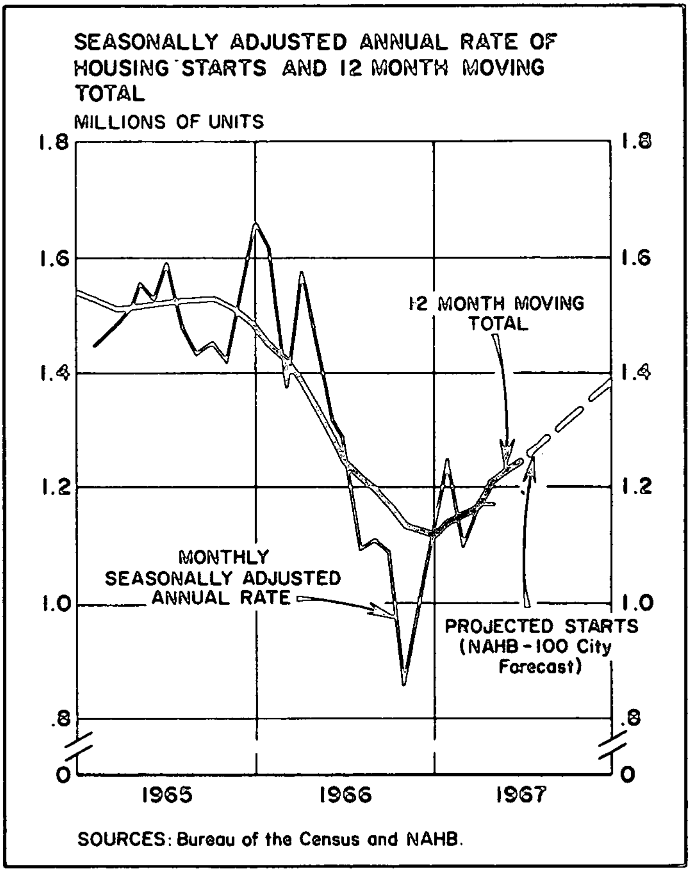
A preliminary look at 1968 indicates a modest recovery—singles to be up 9 percent and multiples 14 percent; actual starts are expected to reach 890,000 singles and 475,000 multiples—a total of 1,365,000 units.

The dollar volume of new housing units built last year was $18.8 billion. During 1967, due primarily to the low level late in 1966, total expenditures on new housing will fall to $17½ billion. By 1968 this figure should be between $19 and $20 billion.

I have provided the committee with some tables and charts, and the forecast for 1967 is shown in chart No. 1.

(Chart 1 follows:)

CHART 1



Let me briefly review some of the factors which will affect home-building activity in the rest of 1967 and during 1968.

Availability of mortgage and construction money will continue to present problems under current monetary and fiscal policies and the high level of governmental activity required by our international obligations. The favorable savings flow into mortgage lending institutions reported during the first half of 1967 (table) may well not be matched in the second half of the year.

In table 1 there are estimates of the flow of funds for the first 6 months of 1967 for the four major institutions. When you read down the line, you can see that life insurance companies are going to increase by 30 percent the flow of funds, savings and loans by 190 percent, commercial banks by 79.3 percent, and mutuals by 217.6 percent, a total of 90 percent over the first 6 months of 1966.

(Table 1 follows:)

TABLE 1.—*Flow of funds into selected savings institutions*

[In millions of dollars]

	Life insurance	Savings and loans	Commercial banks	Mutual savings banks	Total
1966					
January	$926	−$47	$1,167	$246	$2,292
February	606	526	800	219	2,151
March	564	840	2,600	378	4,382
April	678	−772	1,600	−327	1,179
May	560	386	1,600	116	2,662
June	475	1,184	598	243	2,500
July	977	−1,509	1,702	195	1,365
August	449	133	700	160	1,442
September	554	632	−300	374	1,260
October	943	−55	−600	131	419
November	717	612	−600	148	951
December	1,000	1,727	2,000	679	5,406
Total, 1966	8,240	3,657	11,267	2,562	26,009
1965	9,232	8,396	19,986	3,594	41,208
Change (percent)	−10.7	−56.4	−43.6	−28.7	−36.9
1967					
January	$1,268	$309	$4,000	$450	$6,027
February	723	764	2,300	332	4,119
March	932	1,457	3,200	751	6,340
April	705	498	1,400	201	2,804
May	[1] 700	[2] 1,112	[2] 2,900	[2] 445	5,157
June	[1] 625	[1] 2,000	[1] 1,200	[1] 600	4,425
Total, 6 months	4,953	6,140	15,000	2,779	28,872
Percent change, 1966–67	+30.0	+190.0	+79.3	+217.6	+90.4

[1] Estimate.
[2] Preliminary.

Higher levels of consumption coupled with higher taxes will reduce the overall savings rate from the current 6.5 percent level. Offsetting some of this loss will be the fact that savings and loans will have already repaid most of their FHLBB borrowing and have improved their liquidity positions, thereby having a greater portion of new savings for lending. Savings and loans may also not be as severely threatened with the loss of savings stemming from rate competition of other institutions and forms of investment.

I am referring to a table in the June Economic News Notes which shows the liquidity position of savings and loan associations, Mr. Chairman. It shows that the liquidity position of savings and loans has declined to a 26-year low last year and as of the first quarter of this year was still below 10 percent.

Only in 1941 was the liquidity below 10 percent. It is my hope that savings and loans will not be threatened with the loss of savings. I am referring to short-term money markets to which the previous speaker already made reference.

The heaviest corporate bond borrowings on record have passed without too severe a jolt to the market, as shown in table 5. But, Government debt financing will play a significant role in the mortgage market during the second half of 1967 and early 1968. In addition to a substantial debt rollover, the anticipated budget deficit—for which I have seen figures ranging from $8 to $29 billion—could heavily tax the Government bond markets. Interest rates on long-term Government bonds are once again approaching the 5-percent peak of 1966 after a low in March and April of this year.

I have tried to show this in chart 4 which shows the tremendous change from the peak of August 29 of last year and a decline to a low on January 26 and a rather dramatic upturn in the yield of U.S. Government bonds.

Recent increases in Government bond yields have been reflected in the mortgage market in May and early June. Offerings of mortgages to FNMA had declined to a weekly low of 306 during the last week in April—I am referring to chart 3—but have risen spectacularly to more than 4,500 during the week ending June 15, 1967. Chart 4 does not show what really happened because the offerings would have gone to the middle of the chart above it.

Conventional interest rate series as published by FHA, after declining for 5 months, rose by 0.05 percent in May—this is shown in chart 3—and is expected to increase again during the month of June; the FHLBB series, however, showed some further easing.

(Charts 2, 3, 4, 5, and 6 follow:)

CHART 2

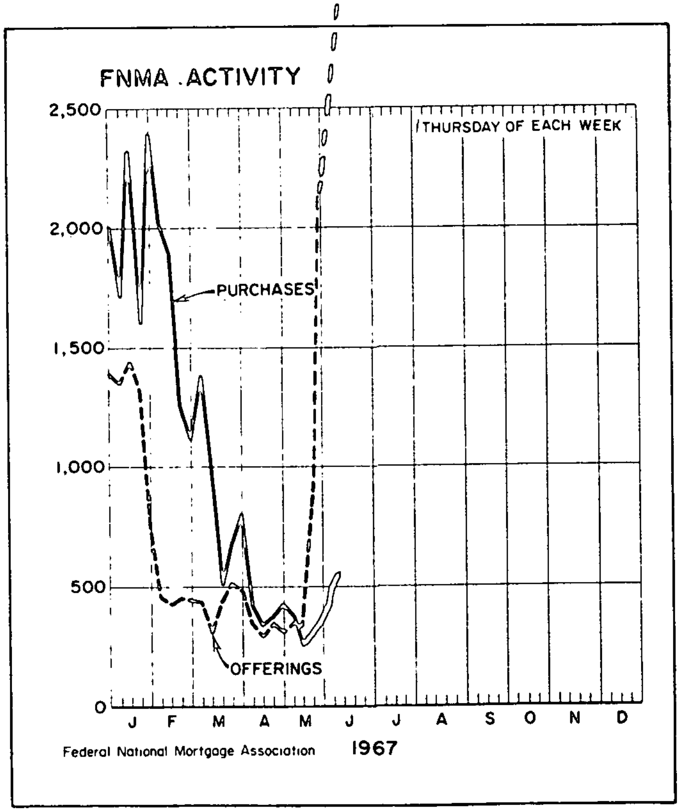
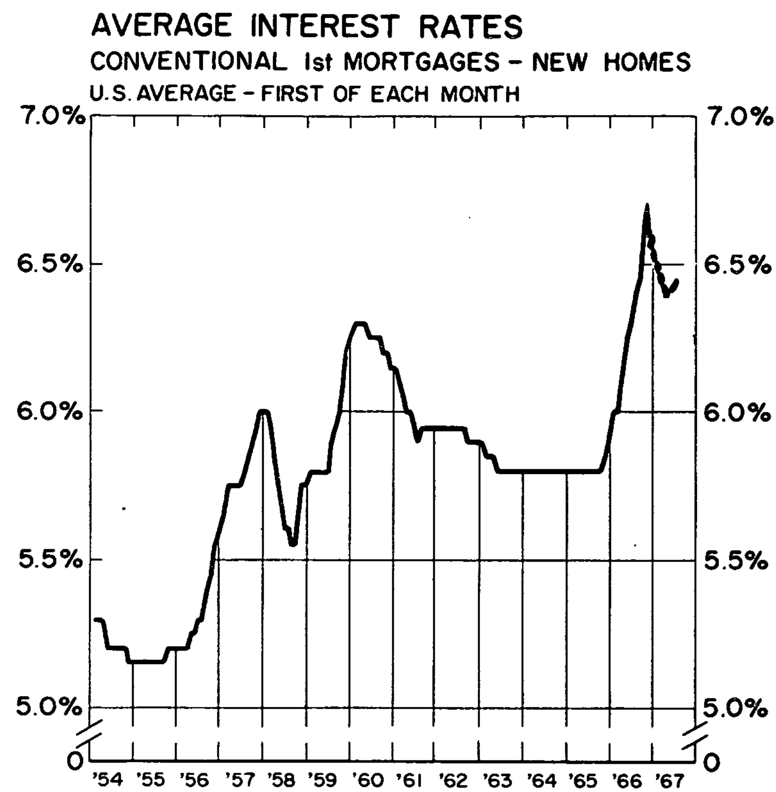
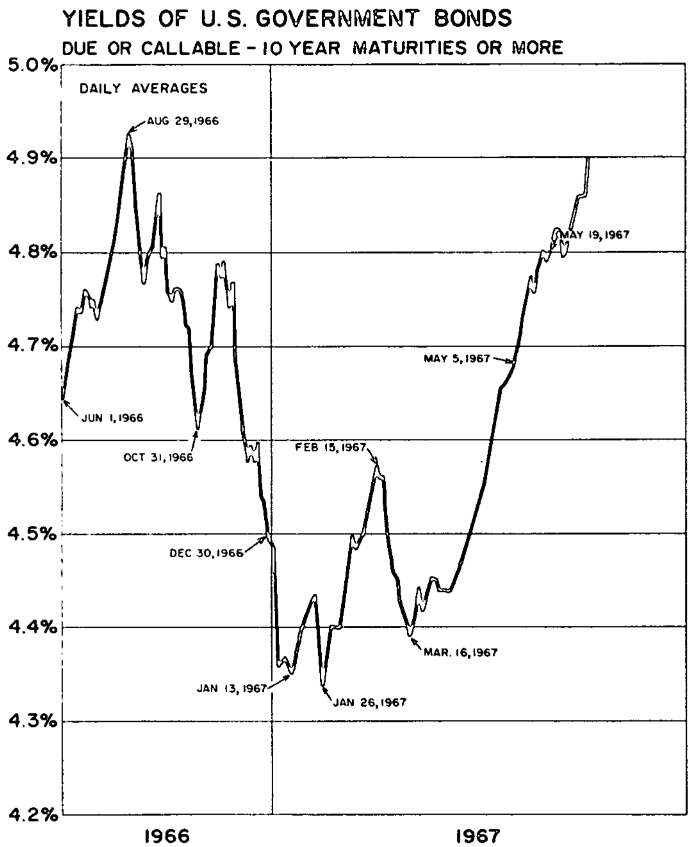


CHART 3



Source: Federal Housing Administration

CHART 4



SOURCES: FED, U.S. Government Security Yields and Prices, Government Finance Section. H.15 and NAHB.

CHART 5

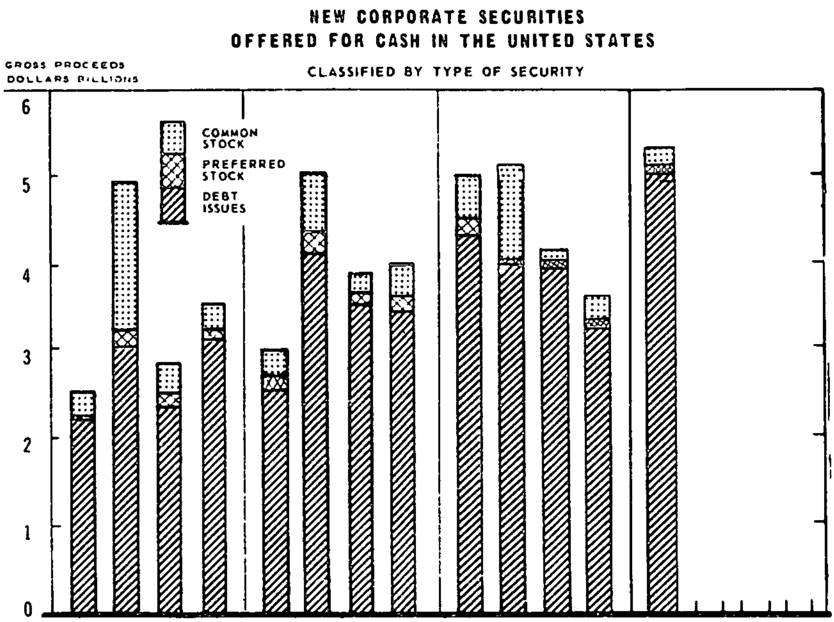
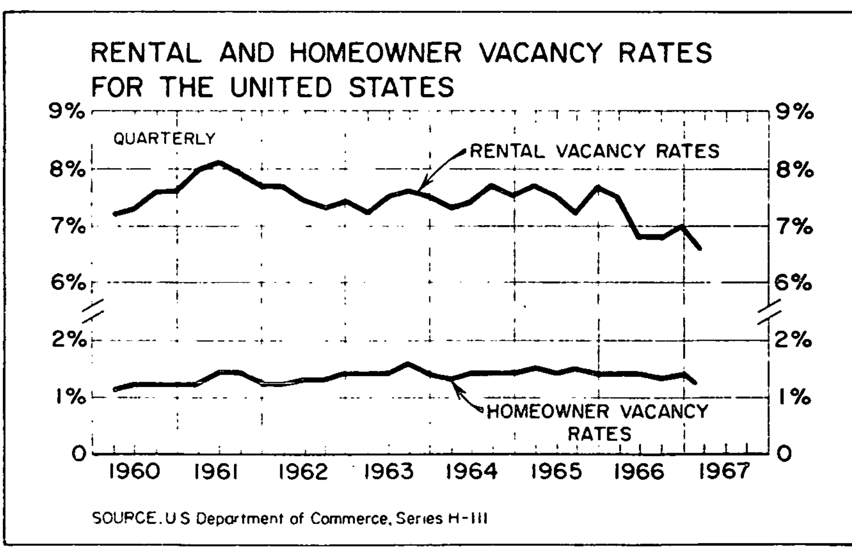


CHART 6



A recent survey by NAHB of leading builders and market analysts on questions of the availability of mortgages and the interest rates confirmed that interest rates had indeed dropped during April, but they rose to their former levels during May and early June. Most metropolitan areas reported upward rate movements; present Government data appear to lag actual events in these areas. In those areas where little change had already occurred there was expectation that change was eminent.

Despite the firming in money markets, builders report some restoration of buyer confidence and the number of home shoppers has increased. Realtor multiple listings have likewise shown a substantial increase, the National Association of Real Estate Boards reports.

As a result of a very low production of last year and a low production of this year, we are building a substantial backlog of housing demand. Indications of this may be found in the substantial reduction in the rental vacancy rate which was 7.7 percent in the final quarter of 1965; the first quarter of 1967 rate was 6.6 percent. Home ownership vacancy rate had also been diminished.

As an indication of this decline is the fact that we have already used 300,000 vacant units from the inventory.

Households last year increased by 1 million which would indicate the postponement of the removal of units from the inventory and perhaps some doubling up of family units. Given the resources, the industry would be capable of producing not only its average 1.5 to 1.6 million units annually but an additional 100,000 to 300,000 units to satisfy the pent-up demand.

Allowing for repayment of mortgage debt, our association estimates that debt on one- to four-family homes will increase during 1967 to an estimated $238 billion, nearly $13 billion over the 1966 yearend figure. Multifamily debt will increase by $3.5 billion, thereby generating a net capital requirement of $16.5 billion. This compares to $15.2 billion in 1966, and $21.5 billion in 1964 and 1965.

In summary, on the basis of early year activity and money availability at that time, we have been hoping for an increase of some 100,000 over the volume last year. As you know, Mr. Chairman, 1966 was off 300,000 units from the year 1965.

Last year, on the basis of financial commitments made prior to actual money tightness, the volume was high in the first half and lower in the second. It has been our hope that we would see a reversal of that pattern in 1967. If mortgage money is available, then that is certainly within reach.

We would be less than candid, however, if we expressed ourselves as completely happy with the outlook at this time, and there are clouds on the horizon in the light of heavy financial demands throughout the economy.

Thank you very much.

(Additional tables and the publication Economic News Notes, referred to by Mr. Sumichrast, follow:)

TABLE 2.—*Investment needs for housing, 1965–75*

[In billions of dollars]

	1965	1966	1967	1968	1975
Net requirements:					
Total 1 to 4 housing units (new and existing)	$16.1	$11.6	$13.0	$14.3	$31.0
Total 5 housing units and over (new and existing)	5.4	3.6	3.5	4.2	7.0
Total, net requirements	21.5	15.2	16.5	18.5	38.0

TABLE 3.—*Value of new private housing units put in place, 1959–68*

Year	Millions of dollars	Percent change from previous year
1959	19,233	
1960	16,410	−15
1961	16,189	−1
1962	18,638	+15
1963	20,064	+8
1964	20,612	+3
1965	20,765	+1
1966	18,773	−10
1967	17,500	−7
1968	19,500	+11

TABLE 4.—*Metropolitan area, 4th quarter*

	1966	1967	Percent change	1st half			1st 9 months			1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
				1966	1967	Percent change	1966	1967	Percent change						
Akron, Ohio, SMSA, James S. Speakman, U.S. Ceramic Tile Co.:															
Single family	300	300	0	886	875	1–	1,310	1,385	6	1,863	1,610	1,685	1,700	5	1
Multifamily family	250	275	10	971	870	10–	1,197	1,165	3–	1,502	1,447	1,440	1,460	0–	1
Total	550	575	5	1,857	1,745	6–	2,507	2,550	2	3,365	3,057	3,125	3,160	2	1
Albuquerque, N.Mex., SMSA, Dr. Andrew Imrik, Realty Research, Inc.:															
Single family	117	200	71	511	412	19–	653	640	2–	1,288	770	840	1,000	9	19
Multifamily	37	100	170	310	285	8–	368	400	9	677	405	500	500	23	0
Total	154	300	95	821	697	15–	1,021	1,040	2	1,965	1,175	1,340	1,500	14	12
Allentown-Bethlehem, Pa., John Denuel, Pennsylvania Power & Light Co.:															
Single family	350	340	3–	840	850	1	1,360	1,360	0	1,950	1,710	1,700	1,600	1–	6–
Multifamily	200	200	0	1,000	400	60–	1,250	600	52–	1,080	1,450	800	1,100	45–	38
Total	550	540	2–	1,840	1,250	32–	2,610	1,960	25–	3,030	3,160	2,500	2,700	21–	8
Atlanta, Ga., SMSA, Robert Tharpe & Brooks Inc.:															
Single family	507	2,200	334	2,893	4,000	38	3,584	6,300	76	10,120	4,091	8,500	8,500	108	0
Multifamily	441	3,000	580	6,379	2,900	55–	8,564	5,000	42–	9,499	9,005	8,000	8,000	11–	0
Total	948	5,200	449	9,272	6,900	26–	12,148	11,300	7–	19,619	13,096	16,500	16,500	26	0
Atlantic City, N.J., SMSA, Ambrose O'Donnell Jr., Atlantic City Electric Co.:															
Single family	206	177	14–	605	368	39–	823	572	30–	1,074	1,029	749	1,000	27–	34
Multifamily	101	211	109	507	577	14	567	1,015	79	645	668	1,226	1,600	84	31
Total	307	388	26	1,112	945	15–	1,390	1,587	14	1,719	1,697	1,975	2,600	16	32
Austin, Tex., SMSA, Mrs. E. Morgan, Morgan Research Associates:															
Single family	260	391	50	758	963	27	1,023	1,427	39	1,339	1,283	1,818	1,800	422	1–
Multifamily	315	323	3	1,188	1,091	8–	1,682	1,705	1	969	1,997	2,028	1,500		26–
Total	575	714	24	1,946	2,054	6	2,705	3,132	16	2,308	3,280	3,846	3,300	17	14–

Baltimore, Md., SMSA, Morton Hoffman & Co.:															
Single family	989	1,579	60	3,497	2,798	20—	4,944	4,198	15—	7,406	5,933	5,777	6,750	3—	17
Multifamily	1,725	1,417	18—	5,026	3,596	28—	7,351	5,646	23—	7,794	9,076	7,063	7,450	22—	5
Total	2,714	2,996	10	8,523	6,394	25—	12,295	9,844	20—	15,200	15,009	12,840	14,200	14—	11
Beaumont, Tex., SMSA, Mrs. E. Morgan, Morgan Research Associates:															
Single family	106	95	10—	504	315	38—	710	465	35—	912	816	560	500	31—	11—
Multifamily	34	70	106	275	187	32—	401	287	28—	343	435	357	300	18—	16—
Total	140	165	18	779	502	36—	1,111	752	32—	1,255	1,251	917	800	27—	13—
Billings, Mont., William C. Magelssen, Security Trust & Savings Bank:															
Single family	61	60	2—	173	113	35—	237	188	21—	252	298	248	300	17—	21
Multifamily	12	12	0	48	24	50—	124	36	71—	44	136	48	100	65—	108
Total	73	72	1—	221	137	38—	361	224	38—	296	434	296	400	32—	35
Birmingham, Ala., SMSA, Don Harrell, Jr., Vulcan Materials Co.:															
Single family	484	644	33	1,535	1,281	17—	2,143	2,014	6—	2,881	2,627	2,658	2,707	1	2
Multifamily	181	175	3—	511	570	12	803	869	8	1,057	984	1,044	1,098	6	5
Total	665	819	23	2,046	1,851	10—	2,946	2,883	2—	3,938	3,611	3,702	3,805	3	3
Boston, Mass., SMSA, Robert D. McPeck, NAHB:															
Single family	1,100	950	14—	2,450	1,550	37—	3,597	2,643	27—	5,610	4,697	3,593	4,024	24—	12
Multifamily	900	1,000	11	3,150	1,250	60—	4,172	2,383	43—	9,041	5,072	3,383	3,113	33—	8—
Total	2,000	1,950	3—	5,600	2,800	50—	7,769	5,026	35—	14,651	9,769	6,976	7,137	29—	2
Buffalo, N.Y., SMSA, William T. Hausle, National Gypsum Co.:															
Single family	684	900	32	2,060	1,736	16—	3,125	3,000	4—	4,265	3,809	3,900	4,200	2	8
Multifamily	192	450	134	894	450	50—	1,235	750	39—	1,890	1,427	1,200	1,400	16—	17
Total	876	1,350	54	2,954	2,186	26—	4,360	3,750	14—	6,155	5,236	5,100	5,600	3—	10
Champaign-Urbana, Ill., Helen Westphal, Seymour Kroll & Associates, Inc.:															
Single family	110	150	36	338	277	18—	516	448	13—	790	626	598	625	4—	5
Multifamily	54	110	104	232	286	23	342	286	16—	1,157	396	396	400	0	1
Total	164	260	59	570	563	1—	858	734	14—	1,947	1,022	994	1,025	3—	3
Charlotte, N.C., R. Beaumont, executive vice president, HBA:															
Single family	420	399	5—	1,203	1,140	5—	1,643	1,558	5—	2,216	2,063	1,957	2,152	5—	10
Multifamily	344	501	46	1,263	750	41—	1,734	1,310	24—	2,342	2,078	1,811	1,992	13—	10
Total	764	900	18	2,466	1,890	23—	3,377	2,868	15—	4,558	4,141	3,768	4,144	9—	10

TABLE 4.—*Metropolitan area, 4th quarter*—Continued

	1966	1967	Percent change	1st half			1st 9 months			1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
				1966	1967	Percent change	1966	1967	Percent change						
Chattanooga, Tenn. (Hamilton County), Ray W. Atkinson, executive vice president, HBA:															
Single family	72	250	247	774	600	22–	1,021	950	7–	1,366	1,093	1,200	1,320	10	10
Multifamily	40	40	0	238	180	24–	342	280	18–	481	382	320	400	16–	25
Total	112	290	159	1,012	780	23–	1,363	1,230	10–	1,847	1,475	1,520	1,720	3	13
Chicago-Northwestern, Indiana, Mrs. D. Dulksnys, Bell Savings & Loan Association:															
Single family	3,970	5,500	39	9,889	9,543	3–	15,400	15,943	4	22,070	19,370	21,443	22,500	11	5
Multifamily	4,650	5,300	14	10,482	9,506	9–	14,876	15,006	1	18,203	19,526	20,306	23,000	4	13
Total	8,620	10,800	25	20,371	19,049	6–	30,276	30,949	2	40,273	38,896	41,749	45,500	7	9
Cleveland, Ohio, SMSA, Carl J. Schorr, Advance Mortgage Corp.:															
Single family	975	1,200	23	3,290	2,895	12–	4,700	4,495	4–	6,234	5,675	5,695	6,000	0	5
Multifamily	785	1,200	53	2,650	2,705	2	3,775	4,105	9	5,718	4,560	5,305	6,500	16	23
Total	1,760	2,400	36	5,940	5,600	6–	8,475	8,600	1	11,952	10,235	11,000	12,500	7	14
Colorado Springs Colo., SMSA, James H. Curry, Willman & Curry:															
Single family	272	500	84	770	1,082	41	1,002	1,688	68	1,893	1,274	2,188	1,800	72	18–
Multifamily	28	175	525	315	304	3–	485	479	1–	1,371	513	654	900	27	38
Total	300	675	125	1,085	1,386	28	1,487	2,167	46	3,264	1,787	2,842	2,700	59	5–
Dallas, Tex., SMSA, Oliver Mattingly, M/P. F. Research:															
Single family	1,220	1,345	10	3,673	3,738	2	5,275	5,669	7	7,774	6,495	7,014	7,715	8	10
Multifamily	1,073	1,237	15	3,519	3,202	9–	4,781	4,578	4–	5,602	5,854	5,815	6,862	1–	18
Total	2,293	2,582	13	7,192	6,940	4–	10,056	10,247	2	13,376	12,349	12,829	14,577	4	14
Dayton, Ohio, SMSA, John Remick, Remick & Associates:															
Single family	438	300	32–	2,210	1,492	32–	2,630	1,992	24–	4,420	3,068	2,292	3,500	25–	53
Multifamily	153	150	2–	553	880	59	1,532	1,780	16	3,500	1,685	1,930	2,000	15	4
Total	591	450	24–	2,763	2,372	14–	4,162	3,772	9–	7,920	4,753	4,222	5,500	11–	30–

Denver, Colo., Ray R. Lucore, Public Service Co. of Colorado:															
Single family	915	1,000	9	3,086	2,819	9—	4,321	4,219	2—	5,149	5,236	5,219	5,300	0—	2
Multifamily	653	550	16—	1,345	1,319	2—	2,549	2,069	19—	2,198	3,202	2,619	2,700	18—	3
Total	1,568	1,550	1—	4,431	4,138	7—	6,870	6,288	8—	7,347	8,438	7,838	8,000	7—	2
Des Moines, Iowa, SMSA, Charles B. Ford, planning director:															
Single family	280	275	2—	570	560	2—	854	840	2—	1,295	1,134	1,115	1,100	2—	1—
Multifamily	241	270	12	338	460	36	477	620	30	754	718	890	1,000	24	12
Total	521	545	5	908	1,020	12	1,331	1,460	10	2,049	1,852	2,005	2,100	8	5—
Detroit, Mich, SMSA, D. Donohue, Advance Mort. Corp and D Spear-Owens-Corning:															
Single family	2,625	3,000	14	8,868	7,040	21—	11,963	10,640	11—	18,812	14,588	13,640	14,000	6—	3
Multifamily	1,635	2,200	35	6,138	5,005	18—	8,943	8,205	8—	13,048	10,578	10,405	11,000	2—	6
Total	4,260	5,200	22	15,006	12,045	20—	20,906	18,845	10—	31,860	25,166	24,045	25,000	4—	4
Elkhart County, Ind., Bill Kral, Williams Products Inc.:															
Single family	110	120	9	223	263	18	366	423	16	663	476	543	620	14	14
Multifamily	60	100	67	120	....	100—	190	50	74—	250	250	150	250	40—	67
Total	170	220	29	343	263	23—	556	473	15—	913	726	693	870	5—	26
El Paso, Tex., SMSA, El Paso HBA:															
Single family	205	350	71	650	700	8	920	1,075	17	1,436	1,125	1,425	1,550	27	9
Multifamily	72	95	32	146	231	58	286	391	37	562	358	486	500	36	3
Total	277	445	61	796	931	17	1,206	1,466	22	1,998	1,483	1,911	2,050	29	7
Eugene, Oreg., SMSA, Henry F. Beistel, Eugene Water and Electric Board:															
Single family	122	409	235	682	680	0—	930	1,153	24	1,561	1,052	1,562	1,307	48	16—
Multifamily	249	143	43—	488	357	27—	599	535	11—	643	848	678	763	20—	13
Total	371	552	49	1,170	1,037	11—	1,529	1,688	10	2,204	1,900	2,240	2,070	18	8—
Flint, Mich, SMSA, Aaron J. Blumberg, economic consultant:															
Single family	199	400	101	1,052	736	30—	1,448	1,200	17—	2,142	1,647	1,600	1,500	3—	6—
Multifamily	17	200	N/A	632	190	70—	1,130	500	56—	1,315	1,147	700	1,200	39—	71
Total	216	600	178	1,684	926	45—	2,578	1,700	34—	3,457	2,794	2,300	2,700	18—	17
Fort Worth, Tex., SMSA, Oliver Mattingly, M/P F Research:															
Single family	550	580	5	2,047	1,679	18—	2,809	2,772	1—	3,673	3,359	3,352	3,822	0—	14
Multifamily	380	480	26	922	1,201	30	1,539	1,982	29	2,451	1,919	2,462	2,708	28	10
Total	930	1,060	14	2,969	2,880	3—	4,348	4,754	9	6,124	5,278	5,814	6,530	10	12

TABLE 4.—*Metropolitan area, 4th quarter*—Continued

	1966	1967	Percent change	1st half 1966	1st half 1967	1st half Percent change	1st 9 months 1966	1st 9 months 1967	1st 9 months Percent change	1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
Gary-Hammond-East Chicago, Ind., Kenneth Plant, U.S. Gypsum Co.:															
Single family	342	500	46	1,076	730	32–	1,541	1,430	7–	2,716	1,883	1,930	2,400	2	24
Multifamily	187	175	6–	685	319	53–	1,002	469	53–	426	1,189	644	650	46–	1
Total	529	675	28	1,761	1,049	40–	2,543	1,899	25–	3,142	3,072	2,574	3,050	16–	18
Grand Rapids, Mich., SMSA, R. A. Drickey, Whirlpool Corp. (G. Herrema, executive vice president, HBA):															
Single family	457	530	16	1,539	1,365	11–	2,171	1,945	10–	3,436	2,628	2,475	2,730	6–	10
Multifamily	123	257	109	418	405	3–	700	698	0–	340	823	955	1,170	16	23
Total	580	787	36	1,957	1,770	10–	2,871	2,643	8–	3,776	3,451	3,430	3,900	1–	14
Greenville, S.C., Edgar W. Teasley, executive vice president, HBA:															
Single family	185	300	62	831	676	19–	1,133	1,216	7	1,836	1,318	1,516	1,300	15	14–
Multifamily	25	25	0	91	164	80	101	189	87	202	126	214	350	70	64
Total	210	325	55	922	840	9–	1,234	1,405	14	2,038	1,444	1,730	1,650	20	5–
Harrisburg, Pa., SMSA, Thomas J. Pflieger-Certain-Teed Products Corp.:															
Single family	104	135	30	331	361	9	503	554	10	733	607	689	713	14	3
Multifamily	36	152	322	657	429	35–	865	647	25–	748	901	799	837	11–	5
Total	140	287	105	988	790	20–	1,368	1,201	12–	1,481	1,508	1,488	1,550	1–	4
Honolulu, Hawaii, SMSA, Dr. Thomas K. Hitch, First National Bank of Hawaii:															
Single family	508	800	57	1,717	1,150	33–	2,435	1,850	24–	4,512	2,943	2,650	3,000	10–	13
Multifamily	974	1,200	23	4,089	1,950	52–	5,378	3,050	43–	5,689	6,352	4,250	4,800	33–	13
Total	1,482	2,000	35	5,806	3,100	47–	7,813	4,900	37–	10,201	9,295	6,900	7,800	26–	13
Houston, Tex., SMSA, Independent Research Associates, Inc.:															
Single family	1,047	1,450	38	4,280	3,864	10–	5,824	5,684	2–	8,635	6,871	7,134	7,500	4	5
Multifamily	1,248	1,910	53	3,424	3,800	11	5,447	5,850	7	6,024	6,695	7,760	8,400	16	8
Total	2,295	3,360	46	7,704	7,664	1–	11,271	11,534	2	14,659	13,566	14,894	15,900	10	7

Kansas City, Kans-Mo., SMSA, John L. Hysom,Jr.-J. L. Hysom & Associates:															
Single family	623	1,400	125	3,170	2,786	12–	4,147	4,486	8	7,186	4,770	5,886	6,000	23	2
Multifamily	893	1,200	34	1,749	1,863	7	2,773	3,463	25	4,819	3,666	4,663	4,800	27	3
Total	1,516	2,600	72	4,919	4,649	5–	6,920	7,949	15	12,005	8,436	10,549	10,800	25	2
Lancaster, Pa., John Denuel-Pennsylvania Power & Light Co.:															
Single family	300	290	3–	680	650	4–	1,090	1,010	7–	1,480	1,390	1,300	1,350	6–	4
Multifamily	100	120	20	320	210	34–	440	330	25–	595	540	450	450	17–	0
Total	400	410	3	1,000	860	14–	1,530	1,340	12–	2,075	1,930	1,750	1,800	9–	3
Las Vegas, Nev. SMSA, John M. Beville-Bank of Nevada:															
Single family	36	28	22–	417	222	47–	551	322	42–	1,077	587	350	350	40–	0
Multifamily	153	....	100–	60	10	83–	69	10	86–	445	222	10	10	95–	0
Total	189	28	85–	477	232	51–	620	332	46–	1,522	809	360	360	56–	0
Lexington, Ky. SMSA, Leonard Paulson, executive vice president, HBA:															
Single family	123	140	14	607	680	12	814	925	14	1,690	937	1,065	1,378	14	29
Multifamily	55	86	56	622	479	23–	768	632	18–	1,084	823	718	812	13–	13
Total	178	226	27	1,229	1,159	6–	1,582	1,557	2–	2,774	1,760	1,783	2,190	1	23
Little Rock, Ark., SMSA, Metropolitan Area Planning Commi ion of Pulaski County:															
Single family	150	155	3	704	536	24–	963	801	17–	1,860	1,113	956	1,327	14–	39
Multifamily	50	50	0	397	105	74–	540	165	69–	1,501	590	215	640	64–	198
Total	200	205	3	1,101	641	42–	1,503	966	36–	3,361	1,703	1,117	1,967	31–	68
Louisville and Jefferson City, Ky., John W. Robinson, executive vice president, HBA:															
Single family	391	890	128	1,556	1,574	1	2,108	2,634	25	4,715	2,499	3,524	3,962	41	12
Multifamily	737	560	24–	514	821	60	983	1,241	26	3,245	1,720	1,801	2,100	5	17
Total	1,128	1,450	29	2,070	2,395	16	3,091	3,875	25	7,960	4,219	5,325	6,062	26	14
Memphis, Tenn., P. R. Lowry, Memphis State University:															
Single family	662	660	0–	1,589	1,605	1	2,126	2,385	12	3,448	2,778	3,045	3,400	9	12
Multifamily	447	550	23	1,534	1,313	14–	1,960	2,063	5	2,696	2,407	2,613	2,600	9	0–
Total	1,109	1,210	9	3,123	2,918	7–	4,086	4,448	9	6,144	5,195	5,658	6,000	9	6

TABLE 4.—*Metropolitan area, 4th quarter*—Continued

	1966	1967	Percent change	1st half 1966	1st half 1967	1st half Percent change	1st 9 months 1966	1st 9 months 1967	1st 9 months Percent change	1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
Milwaukee, Wis., SMSA, E. A. Nelson, Badger Meter Manufacturing Co.:															
Single family	465	500	8	1,715	1,060	38–	2,380	1,760	26–	3,602	2,845	2,260	3,000	21–	33
Multifamily	405	500	23	2,738	1,189	57–	3,428	2,089	39–	5,709	3,833	2,589	3,500	32–	35
Total	870	1,000	15	4,453	2,249	49–	5,808	3,849	34–	9,311	6,678	4,849	6,500	27–	34
Nashville, Tenn., Metropolitan Planning Commission:															
Single family	305	400	31	992	1,224	23	1,349	1,724	28	2,091	1,654	2,124	2,200	28	4
Multifamily	429	500	17	1,368	1,283	6–	1,896	2,083	10	2,233	2,325	2,583	2,600	11	1
Total	734	900	23	2,360	2,507	6	3,245	3,807	17	4,324	3,979	4,707	4,800	18	2
Newark, N.J. (city), Philip J. Parelli, Division of City Planning:															
Single family															
Multifamily	8	40	400	425	215	49–	508	310	39–	828	516	350	400	32–	14
Total	8	40	400	425	215	49–	508	310	39–	828	516	350	400	32–	14
New Jersey, Somerset County, William E. Roach, Jr., planning director:															
Single family	250	250	0	607	304	50–	875	554	37–	1,781	1,125	804	1,000	29–	24
Multifamily	50	100	100	81	149	84	157	249	59	969	207	349	500	69	43
Total	300	350	17	688	453	34–	1,032	803	22–	2,750	1,332	1,153	1,500	13–	30
Newport News-Hampton, Va., SMSA, Lone Star Cement Corp.:															
Single family	201	450	124	871	1,060	22	1,156	1,610	39	2,940	1,357	2,060	2,100	52	2
Multifamily	97	225	132	766	343	55–	971	593	39–	1,133	1,068	818	1,000	23–	22
Total	298	675	127	1,637	1,403	14–	2,127	2,203	4	4,073	2,425	2,878	3,100	19	8
Norfolk-Portsmouth, Va., SMSA, Lone Star Cement Corp.:															
Single family	325	725	123	1,725	1,403	19–	2,240	2,253	1	3,651	2,565	2,978	3,000	16	1
Multifamily	93	400	330	1,088	828	24–	1,283	1,278	0–	2,961	1,376	1,678	1,800	22	7
Total	418	1,125	169	2,813	2,231	21–	3,532	3,531	0	6,612	3,941	4,656	4,800	18	3

Oklahoma City, Okla., Sidney Davidoff, EX. V.P. H.B.A.:															
Single family	446	700	57	1,827	1,507	18−	2,426	2,207	9−	4,458	2,872	2,907	3,600	1	24
Multifamily	180	350	94	266	643	142	295	1,093	271	1,392	475	1,443	1,500	204	4
Total	626	1,050	68	2,093	2,150	3	2,721	3,300	21	5,850	3,347	4,350	5,100	30	17
Omaha, Nebr., SMSA, Ted Wright, Griffin Pipe Products Co.:															
Single family	274	400	46	1,075	1,034	4−	1,561	1,584	1	2,488	1,835	1,984	2,500	8	26
Multifamily	496	400	19−	727	759	4	1,095	1,209	10	2,054	1,591	1,609	1,850	1	15
Total	770	800	4	1,802	1,793	0−	2,656	2,793	5	4,542	3,426	3,593	4,350	5	21
Orlando, Fla., W. L. O'Neill, Moen Co.:															
Single family	380	300	21−	965	550	43−	1,296	950	27−	2,090	1,676	1,250	1,500	25−	20
Multifamily	440	600	36	1,130	900	20−	1,480	1,700	15	1,427	1,920	2,300	2,600	20	13
Total	820	900	10	2,095	1,450	31−	2,776	2,650	5−	3,517	3,596	3,550	4,100	1−	15
Phoenix, Ariz., SMSA, V. D. Hunt, Jr., O'Malley Cos.:															
Single family	859	1,400	63	2,261	2,268	0	3,193	3,468	9	3,742	4,052	4,868	6,000	20	23
Multifamily	525	400	24−	693	684	1−	1,382	1,034	25−	1,737	1,907	1,434	3,000	25−	109
Total	1,384	1,800	30	2,954	2,952	0−	4,575	4,502	2−	5,479	5,959	6,302	9,000	6	43
Pittsburgh, Pa., R. G. Morrell and D. H. Spiegel-Alcoa:															
Single family	727	1,050	44	2,988	2,579	14−	4,121	4,154	1	5,498	4,848	5,204	5,800	7	11
Multifamily	421	400	5−	1,094	1,438	31	1,736	2,138	23	2,846	2,157	2,538	2,700	18	6−
Total	1,148	1,450	26	4,082	4,017	2−	5,857	6,292	7	8,344	7,005	7,742	8,500	11	10
Portland, Oreg., SMSA, F. I. Weber, Jr., Portland General Electric Co.:															
Single family	1,110	1,067	4−	2,127	2,033	4−	3,494	3,333	5−	4,574	4,604	4,400	4,200	4−	5−
Multifamily	667	730	9	1,567	1,178	25−	2,358	2,220	6−	2,295	3,025	2,950	3,000	2−	2
Total	1,777	1,797	1	3,694	3,211	13−	5,852	5,553	5−	6,869	7,629	7,350	7,200	4−	2−
Providence-Pawtucket, SMSA, W. Kernan, Bostitch, Inc., and Ross Dagatan HBA:															
Single family	718	754	5	1,835	1,499	18−	2,718	2,250	17−	3,600	3,436	3,004	3,605	13−	20
Multifamily	237	251	6	904	676	25−	2,110	826	26−	1,140	1,347	1,077	1,185	20−	10
Total	955	1,005	5	2,739	2,175	21−	3,828	3,076	20−	4,740	4,783	4,081	4,790	15−	17
Raleigh, N.C., J. C. Jordan, Cameron-Brown Co.:															
Single family	178	225	26	460	465	1	581	650	12	967	759	875	985	15	13
Multifamily	345	150	57−	247	509	106	271	584	115	540	616	734	650	19	11−
Total	523	375	28−	707	974	38	852	1,234	45	1,507	1,375	1,609	1,635	17	2

TABLE 4— *Metropolitan area, 4th quarter*—Continued

	1966	1967	Percent change	1st half			1st 9 months			1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
				1966	1967	Percent change	1966	1967	Percent change						
Richmond, Va., SMSA, Stuart I. Kleiman, Reynolds Metals Co.:															
Single family	368	800	117	1,667	1,308	22–	2,164	2,108	3–	3,494	2,532	2,908	3,400	15	17
Multifamily	315	675	114	1,510	1,098	27–	2,068	1,823	12–	3,497	2,383	2,498	2,650	5	6
Total	683	1,475	116	3,177	2,406	24–	4,232	3,931	7–	6,991	4,915	5,406	6,050	10	12
Rochester, N.Y., SMSA, Richard Freitas, Caldwell Manufacturing Co.:															
Single family	625	1,000	60	2,141	1,415	34–	3,126	2,515	20–	4,551	3,751	3,515	4,000	6–	14
Multifamily	317	700	121	1,425	600	58–	1,853	1,200	35–	2,600	2,170	1,900	2,300	12–	21
Total	942	1,700	80	3,566	2,015	43–	4,979	3,715	25	7,151	5,921	5,415	6,300	9–	16
St. Louis, Mo., SMSA, S. S. Sansbury, Union Electric Co.:															
Single family	2,500	2,000	20–	4,700	3,600	23–	7,200	6,000	17–	11,150	9,700	8,000	8,800	18–	10
Multifamily	1,500	1,200	20–	3,300	2,300	30–	5,300	3,800	28–	7,500	6,800	5,000	5,200	26–	4
Total	4,000	3,200	20–	8,000	5,900	26–	12,500	9,800	22–	18,650	16,500	13,000	14,000	21–	8
Saginaw, Mich., Mrs. E. Morgan, Morgan Research Associates:															
Single family	130	150	15	510	323	37–	683	523	23–	895	813	673	700	17–	4
Multifamily	29	50	72	89	64	28–	103	86	17–	352	132	136	150	3	10
Total	159	200	26	599	387	35–	786	609	23–	1,247	945	809	850	14–	5
Salem, Oreg., Fred I. Weber, Jr., Portland General Electric Co.:															
Single family	226	260	15	507	379	25–	781	690	12–	1,123	1,007	950	1,000	6–	5
Multifamily	70	95	36	162	115	29–	281	235	16–	400	351	330	350	6–	6
Total	296	355	20	669	494	26–	1,062	925	13–	1,523	1,358	1,280	1,350	6–	5
San Antonio, Tex., SMSA, George D. Vann, Jr., director of housing and inspections:															
Single family	464	570	23	1,433	1,370	4–	1,960	2,070	6	2,747	2,424	2,640	2,750	9	4
Multifamily	387	500	29	815	1,066	31	1,302	1,666	28	1,548	1,689	2,166	2,200	28	2
Total	851	1,070	26	2,248	2,436	8	3,262	3,736	15	4,295	4,113	4,806	4,950	17	3

San Francisco-Oakland, Calif., SMSA:															
Single family	1,019	1,500	47	5,768	3,425	41–	7,957	6,925	13–	15,665	8,976	8,425	10,000	6–	19
Multifamily	723	1,500	107	3,784	2,262	40–	4,706	4,662	1–	18,265	5,429	6,162	13,000	14	111
Total	1,742	3,000	72	9,552	5,687	40–	12,663	11,587	8–	33,930	14,405	14,587	23,000	1	58
San Jose, Calif., SMSA, T. R. Harrington, California Lands Investment Co.:															
Single family	829	1,450	75	3,024	2,841	6–	4,422	4,691	6	7,057	5,251	6,141	8,000	17	30
Multifamily	433	500	15	960	700	27–	1,318	1,200	9–	3,896	1,751	1,700	2,500	3–	47
Total	1,262	1,950	55	3,984	3,541	11–	5,740	5,891	3	10,953	7,002	7,841	10,500	12	34
Santa Barbara, Calif., SMSA, Michael Towbes, Michael Towbes Construction:															
Single family	106	250	136	634	300	53–	771	520	33–	951	877	770	1,200	12–	56
Multifamily	66	250	279	399	369	8–	511	619	21	2,089	577	869	1,000	51	15
Total	172	500	191	1,033	669	35–	1,282	1,139	11–	3,040	1,454	1,639	2,200	13	34
Seattle-Everett, Wash., SMSA, James T. Mace, the Seattle Times:															
Single family	1,835	2,531	38	4,448	5,381	21	6,718	8,432	26	6,415	8,553	10,963	10,500	28	4–
Multifamily	1,565	3,184	103	2,688	5,751	114	4,426	9,353	111	3,075	5,991	12,537	13,000	109	4
Total	3,400	5,715	68	7,136	11,132	56	11,144	17,785	60	9,490	14,544	23,500	23,500	62	0
South Bend (St. Joseph County) L. Glenn Barbe, department of redevelopment:															
Single family	81	128	58	349	314	10–	496	494	0–	790	577	622	640	8	3
Multifamily	22	72	227	20	132	560	50	132	164	168	72	204	503	183	147
Total	103	200	94	369	446	21	546	626	15	958	649	826	1,143	27	38
Spokane, Wash., SMSA, Dean R. Peterson, Simpson Timber Co.:															
Single family	133	143	8	389	404	4	514	579	13	742	647	722	730	12	1
Multifamily	80	83	4	216	158	27–	293	239	18–	195	373	322	355	14–	10
Total	213	226	6	605	562	7–	807	818	1	937	1,020	1,044	1,085	2	4
Syracuse, N.Y., SMSA, W. E. Reed, the Flintkote Co.:															
Single family	251	300	20	823	619	25–	1,280	919	28–	1,606	1,531	1,219	1,250	20–	3
Multifamily	316	300	5–	764	751	2–	852	1,051	23	1,818	1,168	1,351	1,450	16	7
Total	567	600	6	1,587	1,370	14–	2,132	1,970	8–	3,424	2,699	2,570	2,700	5–	5
Tacoma, Wash., SMSA, William C. Glor, Weyerhaeuser Co.:															
Single family	399	420	5	917	1,250	36	1,406	1,780	27	1,922	1,805	2,200	1,900	22	14–
Multifamily	122	150	23	404	725	79	569	1,000	76	836	691	1,150	840	66	27–
Total	521	570	9	1,321	1,975	50	1,975	2,780	41	2,758	2,496	3,350	2,740	34	18–

Metropolitan area, 4th quarter—Continued

	1966	1967	Percent change	1st half 1966	1st half 1967	1st half Percent change	1st 9 months 1966	1st 9 months 1967	1st 9 months Percent change	1965	1966	1967	1968	Percent change 1966–67	Percent change 1967–68
Tampa/St. Petersburg, Fla., SMSA, T. C. Heilbrun, First Federal Saving & Loan:															
Single family	974	1,200	23	2,911	2,591	11–	4,113	3,791	8–	6,384	5,087	4,991	5,000	2–	0
Multifamily	678	600	12–	1,392	1,742	25	1,884	2,542	35	1,865	2,562	3,142	3,500	23	11
Total	1,652	1,800	9	4,303	4,333	1	5,997	6,333	6	8,249	7,649	8,133	8,500	6	5
Toledo, Ohio, SMSA, Aaron J. Blumberg, economic consultant:															
Single family	196	300	53	895	782	13–	1,204	1,300	8	1,722	1,400	1,600	1,800	14	13
Multifamily	143	200	40	772	600	22–	1,091	1,000	8–	1,362	1,234	1,200	1,400	3–	17
Total	339	500	47	1,667	1,382	17–	2,295	2,300	0	3,084	2,634	2,800	3,200	6	14
Tucson, Ariz., SMSA, V. D. Hunt, Jr., O'Malley Cos.:															
Single family	172	250	45	457	461	1	622	661	6	1,238	794	911	1,500	15	65
Multifamily	45	140	211	515	213	59–	600	313	48–	724	645	453	1,000	30–	121
Total	217	390	80	972	674	31–	1,222	974	20–	1,962	1,439	1,364	2 500	5–	83
Tulsa, Okla., D. B. Ross, executive vice president, HBA:															
Single family	650	600	8–	1,900	943	50–	2,850	1,543	46–	3,824	3,500	2,143	2,500	39–	17
Multifamily		625		1,200	1,250	4	1,725	1,875	9	2,180	1,725	2,500	2,500	45	9
Total	650	1,225	88	3,100	2,193	29–	4,575	3,418	25–	6,004	5,225	4,643	5,000	11–	8
Vallejo-Napa, Calif., SMSA, W. N. Rodgers, Fibreboard Corp.:															
Single family	203	350	72	909	635	30–	1,183	1,035	13–	1,407	1,386	1,385	1,900	0–	37
Multifamily	108	200	85	611	280	54–	751	480	36–	821	859	680	1,300	21–	91
Total	311	550	77	1,502	915	40–	1,934	1,515	22–	2,228	2,245	2,065	3,200	8–	55
Washington, D.C., SMSA, M. Sumichrast (NAHB) and J. Darby, Chesapeake & Potomac Telephone Co.:															
Single family	1,469	3,500	138	7,669	4,259	44–	9,690	7,259	25–	14,870	11,159	10,759	10,200	4–	5–
Multifamily	4,221	7,500	78	20,543	9,247	55–	26,454	15,747	40–	33,388	30,675	23,247	23,600	24–	2
Total	5,690	11,000	93	28,122	13,506	52–	36,144	23,006	36–	48,258	41,834	34,006	33,800	19–	1–

Wichita, Kans., Frank Malone, president, Fidelity Title Co.:															
Single family	157	225	43	367	514	40	569	764	34	846	726	989	1,200	36	21
Multifamily	171	150	12–	256	267	4	370	367	1–	846	541	517	500	4–	3–
Total	328	375	14	623	781	25	939	1,131	20	1,692	1,267	1,506	1,700	19	13
Wilmington, Del. (Delaware portion), C. B. Reeder, E. I. du Pont de Nemours & Co.:															
Single family	278	400	44	1,123	850	24–	1,533	1,400	9–	2,278	1,811	1,800	2,000	1–	11
Multifamily	180	150	17–	854	800	6–	1,165	1,050	10–	2,173	1,345	1,200	1,200	11–	0
Total	458	550	20	1,977	1,650	17–	2,698	2,450	9–	4,451	3,156	3,000	3,200	5–	7

NATIONAL ASSOCIATION OF HOME BUILDERS

ECONOMIC NEWS NOTES

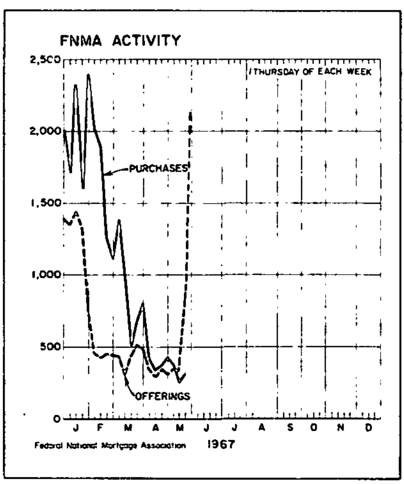
Economics Department o Michael Sumichrast, Director o Norman Farquhar, Associate Director o Suzanne Muncy, Research Assistant

NOTES ON HOUSING AND ECONOMIC SCENE

June 1967

The home building industry, all too swiftly, is again confronted with a tightening mortgage market. This development, indicated in the May "News Notes," has occurred with startling speed.

Prices of FHA-VA mortgages in the past two weeks declined from par or 99 to a 96-95 level, and offerings of mortgages to FNMA increased three-fold (Chart 1). Financial institutions, in many cases, stopped making long-term future commitments. Interest rates, which had been dropping, firmed. Construction money and conventional mortgages, in some areas, have become difficult to obtain.



For how long and to what extent this tightening will continue finds no clear-cut unanimity of opinion among many private and government economists.

A special survey of builders and metropolitan housing forecasters indicates that to date the tightening of money has been felt only slightly in many local areas. FHA VA points have risen on the average close to two points and the conventional interest rate by nearly ¼%. These new rates do not yet exceed the February-March levels. Nationally long term interest rates and yields have shown a more substantial increase.

At a recent round-table of economists, some foresaw the nation's slowing economic growth and the record flow of funds into savings institutions as precluding a repeat of last year's situation and that the current situation is only temporary.

In any case, much of the corporate borrowing in the first quarter -which has upset the mortgage sector was anticipatory of a late-year squeeze and the result of postponed borrowing from last year.

Indications are that borrowing on the part of business will be lower during the second and third quarters. Already this is apparent in the decline of offerings in the June bond market. However, the government will be getting into the market soon to raise some $40 billion through short-term borrowing.

WHAT HAPPENED IN MONEY MARKETS

1. HEAVY CORPORATE BORROWING

First quarter figures show $5.4 billion in new corporate securities were offered by business for cash sales, up substantially from $4 billion in the fourth quarter of 1966. Over $5 billion of this was in the bond market. About 46% of the issues offered was for manufacturing, a strong increase over previous periods. More than 70% of the net proceeds in the first quarter of 1967 has been earmarked for plant and equipment, slightly up from about 69% of the total offerings ($17.8 billion) raised in corporate securities in 1966.

The increase in plant and equipment investment last year was partially responsible for the heavy demand for loanable funds. This aggravated the money market in general, and the mortgage markets in particular.

The first quarter offering of $5.4 billion in corporate securities indicated an annual rate of over $20 billion. This would be substantially higher than the $17.8 billion raised last year. Whether this amount actually will be reached is questionable since, as has been noted, some slackening already is evident.

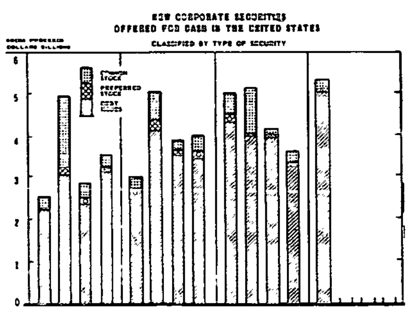
BOND OFFERINGS
First Quarter 1966–1967
(Thousands of Dollars)

Month	1966	1967	% Change
January	$1,151,960	$1,593,117	+38%
February	1,142,705	1,261,774	+10
March	2,064,654	2,219,430	+ 7
Total	$4,359,319	$5,074,320	+17%

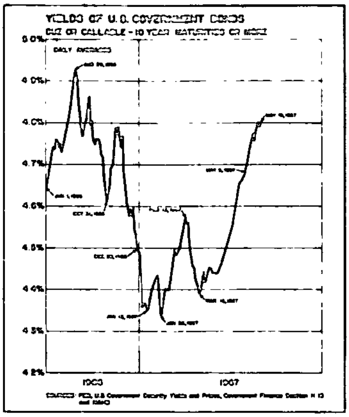
The *Weekly Bond Buyer* called the past financial market activity..."Glutted Market.....in which issuers had to give up more yield to float bonds" and cites two reasons for this. One is Treasury Secretary Fowler's raising of the federal deficit estimate and the other "dawning realization that no relief of the jammed financing calendar is in sight."

The crowded financial calendar and the decline in bond prices forced the city of New York to cancel a sale of $96 million worth of bonds for a housing project. Current prices would have forced a rent increase for the proposed middle-income dwellers if the City had gone through with the issue. For similar reasons, the Textron Corporation dropped plans for raising $100 million in 25-year debentures.

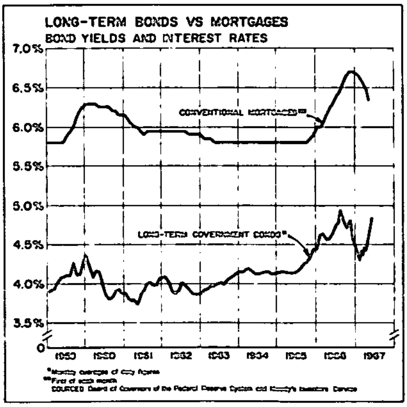
The total June calendar of corporate financing for institutional investors thus far shows about $1.2 billion of offerings in bond markets with the highest single offerings by Southwestern Bell Telephone, $150 million 36-years debentures coming up June 7, 1967. This is substantially below the average monthly figures for the first five months of 1967.



What yields did lately is depicted in the two following charts. The sharp upturn in the yield of U.S. Government long-term bonds started about two



months ago. It has been going on uninterruptedly since. From a low of 4.39% reached on March 16 it had risen to 4.80% on May 18 or 41 basic points. The second chart shows the changes in long-term government bonds and mortgage rates with the narrowing spread between the two. Inference: mortgage rates must turn up, or bonds must decline.



In the private bond market, yields keep creeping upward with a rather severe decline in prices. For instance, Connecticut Light and Power Company "Aaa" 30-year first mortgage bonds yield 5.90%; "A" bond of Interstate Power Company, yield 6.10%; "Baa" Eastern Associated Cola Bonds with a sell-out, priced to yield 6.50%, etc.

2. RECORD GOVERNMENT SPENDING, DEBT AND DEFICIT

Recent news of large government expenditures, the request to raise the debt ceiling, and with a substantially higher deficit looming, has contributed heavily to the strain in money markets. It is probably the overwhelming reason.

There is no immediate or critical money need for the private segment of the economy which the money market could not handle. But the sluggish private sector got the money fever with the projections of government expenditures of $135-140 billion for fiscal 1968, the need to increase the debt ceiling by $29 billion, and the anticipated deficit estimated by Chairman Mills of the House Ways and Means Committee to run as high as $29.2 billion.

The government will be in the market in the April-December period for up to $40 billion for re-financing of the debt. Most of this will be in the short term market. Chances are that as a result the short term rate, which has been declining, will be firmed again.

MATURITY SCHEDULE OF
FEDERAL GOVERNMENT BONDS*
(In Millions of Dollars)

1967	Total	U.S. Government and Federal Reserve Banks	Held By All Other Investors
February	$ 7,509	$ 3,686	$ 3,822
March	2,006	202	1,804
April	2,780	228	2,552
May	9,748	6,816	2,932
June	4,237	359	3,878
August	10,965	6,110	4,857
October	457	-	457
November	10,154	7,509	2,645
Total	$47,857	$24,909	$22,948

*Outstanding December 31, 1966 other than Regular Weekly and Annual Treasury Bills.

The immediate problem of financing the war is complicated by the current trend of the government to finance debt with a shorter average maturity and to concentrate debt financing within a 5-year span. The average maturity of the marketable debt was raised from 4 years 2 months in September, 1960, to 5 years 5 months in January, 1965. Since then, it declined, due to the tight money situation, to 4 years 5 months at the end of this April. If the current trend should continue and refunding is handled the same way as now, it will decline at the end of December, 1968, to 3 years 8 months.

This is the reason Fowler asked Congress for the extension of maturity on Treasury notes to 10 years from the present 5 year limit and for authority to sell up to $2 billion in Treasury bonds without regard to the statutory 4¼% ceiling. Both requests were rejected by the House Ways and Means Committee, but the Treasury got extension of sales of Treasury notes to seven years.

3. LIQUIDITY PROBLEMS

In this financial climate, lending institutions need to stay as short as possible on loans. Lenders, remembering last year, are reluctant to tie up available liquid assets in long-term loans.

For home building, the liquidity position of S&Ls is of prime interest. Savings and loans, after all, supply almost half of home mortgages.

Normally, it could be expected that S&Ls would invest about 70-75% of their new funds in mortgages. The balance would be used for repayments of borrowed money and for liquidity purposes.

However, the first quarter, 1967, shows that 67.8% of the new funds were used for repayments, 15.4% for raising liquidity levels, and only 16.8% for new mortgages.

Last year the S&Ls dropped to a 26 year low in their liquidity (Table 3). Not since 1941 had the amount of money they hold in cash on hand or in the bank and government securities dropped to under 10%. In 1966, this ratio declined to 9.6%, or the same as in 1941. This rate has been declining steadily since its post-war peak of nearly 40% reached in 1945. And out of this "many S&Ls have large amounts of liquidity locked up in long-term securities," to quote HLBB Chairman Horne.

The need for rebuilding of liquidity has been emphasized over and over again by HLBB officials, arguing that S&Ls should not rely almost entirely on the Federal Home Loan District Banks.

On the other hand, a liquidity build-up is needed as a buffer against tight money at a later date. This is what the S&Ls have been attempting to do.

In the first four months of 1967, they repaid about $2.5 billion to the FHLBB, put more money into cash and government securities, yet their liquidity was still, at the end of April, slightly under 10%. In order to raise liquidity to a 12-14% range they have a long way to go.

LIQUIDITY OF SAVINGS AND LOAN ASSOCIATIONS
1936–1967
(Millions $)

Year	Savings Balances	Cash Deposits in Banks & U.S. Government Securities	Percent of Savings in Liquid Assets
1936	$ 4,194	$ 317	7.6%
1937	4,030	287	7.0
1938	4,077	298	7.3
1939	4,118	347	8.4
1940	6,322	378	8.7
1941	4,682	451	9.6
1942	4,941	728	14.7
1943	5,494	1,318	24.0
1944	6,305	2,034	33.1
1945	7,365	2,870	39.0
1946	8,548	2,545	29.8
1947	9,753	2,300	23.6
1948	10,964	2,118	19.3
1949	12,471	2,342	18.8
1950	13,992	2,411	17.2
1951	16,107	2,669	16.7
1952	19,195	3,076	16.0
1953	22,846	3,399	14.7
1954	27,525	3,984	14.5
1955	32,142	4,401	13.7
1956	37,148	6,901	13.2
1957	41,912	5,679	13.5
1958	47,976	6,734	14.0
1959	54,583	6,970	12.8
1960	62,142	7,690	12.4
1961	70,885	8,921	12.6
1962	80,236	9,874	12.3
1963	91,308	10,659	11.7
1964	101,887	11,181	11.0
1965	110,271	11,304	10.3
1966	113,896	11,123	9.8
1967 1st Quarter	$116,300	$11,592	9.97%

MONEY AND HOME BUILDING OUTLOOK

Government borrowing, the war, and the sluggish national economy are the contributors to the uncertain haze surrounding the money markets and home building activity.

At this point in time, only possibilities can be raised and assumptions made.

Much depends on the general economy. The total volume of goods and services (Gross National Product) produced during the first quarter totaled $764 billion, $4.5 billion higher than the final quarter of 1966. But after adjusting for price increases, the total GNP actually declined for the first time since the last recession.

Should the overall economy continue sluggish into the second half, it could be argued there will be no appreciable decline in the savings rate which hit near records of over $22 billion in the first five months (Table). The May rate may be equally high.

FLOW OF FUNDS INTO
SELECTED SAVINGS INSTITUTIONS

(In Millions of Dollars)

Month 1966	Life Insurance	Savings & Loans	Commercial Banks	Mutual Savings Banks	Total
January	$ 926	$ −47	$ 1,167	$ 246	$ 2,292
February	606	526	800	219	2,151
March	564	840	2,600	378	4,382
April	678	−772	1,600	−327	1,179
May	560	386	1,600	116	2,662
June	475	1,184	598	243	2,500
July	977	−1,509	1,702	195	1,365
August	449	133	700	160	1,442
September	554	632	−300	374	1,260
October	943	−55	−600	131	419
November	717	612	−600	148	951
December	1,000	1,727	2,000	679	5,406
1966	8,240	3,657	11,267	2,562	26,009
1965	9,232	8,396	19,986	3,594	41,208
Change	−10.7	−56.4	−43.6	−28.7	−36.9

Month 1967	Life Insurance	Savings & Loans	Commercial Banks	Mutual Savings Banks	Total
January	$1,268	$ 351	$ 4,000	$ 450	$ 6,069
February	723	752	2,300	332	4,107
March	932	1,422	3,200	751	6,305
April	800e	512p	1,300p	175p	2,787
May	750e	1,000e	1,400e	450e	3,600
Total 5 mos.	$4,473	$4,037	$12,200	$2,158	$22,868
% Change 1966–67	+34.2	+332.7	+57.1	+241.5	+80.5

p—preliminary. e—estimate.

A favorable flow of savings, therefore, would continue—savings that would be available for mortgages. But interest rates will be higher or, at best, unchanged from the firmer tone being taken today.

Second, but if a raising GNP is assumed in the second half, with more business and household demand for funds, and a further worsening in the price structure, then there will be a retreat from the savings rate of over 7%, one of the highest rates in recent years.

The odds are that economic activity will pick up as we move into summer and fall, creating a later strain on the mortgage markets.

A third possibility is that what we are undergoing is a short-term phenomenon--a "digestive" period. After the current scramble for money subsides, we may again see relaxation in the money markets, and increased demand for mortgages through 1967. But, again, rates will be firmer.

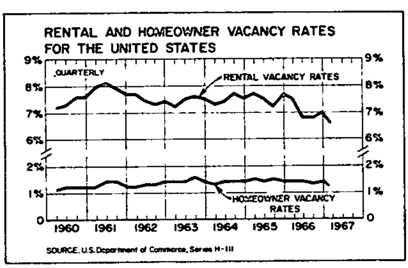
HOUSING

Housing starts in the first four months of 1967 were off 22% from the same period of a year ago Most of the decline was in the multi-family sector where activity was down 32°o. Starts totaled 112,800 units during the period, down from 165,000 a year ago.

HOUSING STARTS, MONTHLY DATA*
(In Millions of Units)

Month	Seasonally Adjusted Annual Rate 1966	1967	%	Monthly Actual Starts 1966	1967	%
January	1,611	1,297	-20%	86.4	65.1	-25%
February	1,374	1,163	-15%	78.2	64.1	-18%
March	1,569	1,161	-26%	126.3	95.0	-25%
April	1,502	1,171	-22%	147.1	114.3	-22%
May	1,318			135.4		
June	1,285			127.5		
July	1,088			104.0		
August	1,107			105.4		
September	1,075			92.4		
October	848			80.3		
November	1,012			75.3		
December	1,089			63.6		

*Private including Farm.

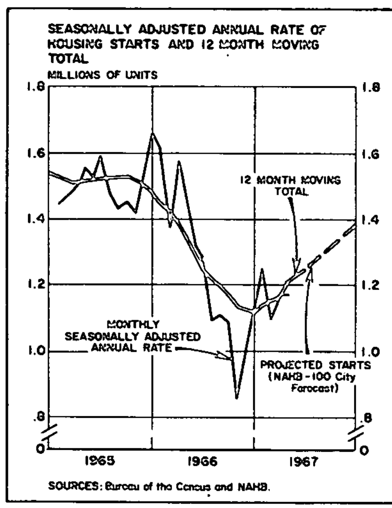


Single family starts totaled 225,700 units as compared to 270,000 during the first four months of 1966, a decline of 17°o. April to April comparisons showed a similar rate of decline.

April building permits in the multi-family sector were off 22% from April, 1966, single family permits off 11%. But total permits rose to 1,003,000 units, highest rate in almost a year.

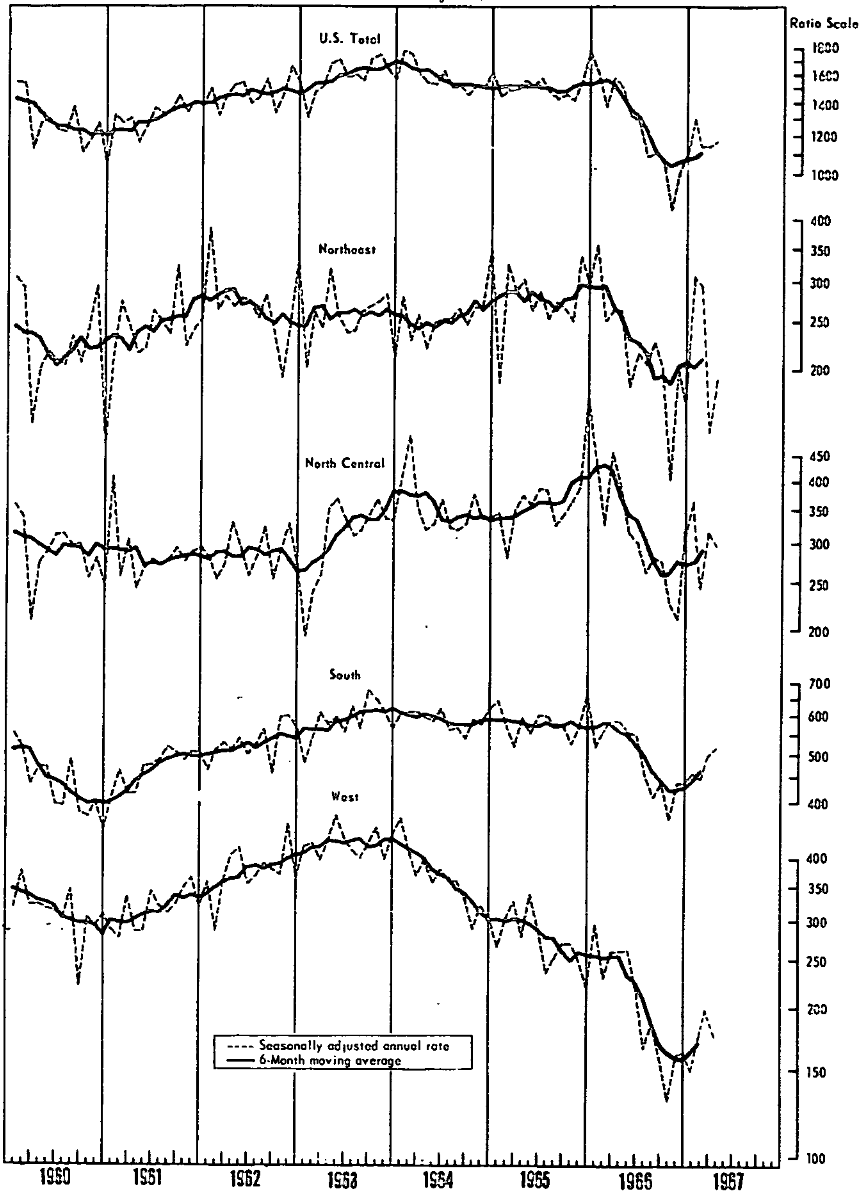
In the meantime, vacancy rates continue to drop (Chart). Data for the first quarter of 1967 indicates the rental vacancy rate to be 6.6°o of inventory, down from 7.0% in the fourth quarter and 7.5% in the first quarter of 1966. This is the lowest level since the Bureau of the Census has been measuring the inventory. The homeowners vacancy rate continues low at 1.3% of the inventory; during the first quarter of 1966 it was 1.4%. (See Chart.)

The key determinant in the housing sector, therefore, will be the availability of money if the industry is to move up toward normal and basically-needed levels of production.



NEW PRIVATE HOUSING STARTS, INCLUDING FARM, UNITED STATES AND REGIONAL TOTALS, SEASONALLY ADJUSTED AND 6-MONTH AVERAGES, 1960 to 1967

(Thousands of housing units)



THE LATEST FIGURES ENTERED ARE PRELIMINARY.

SOURCE BUREAU OF THE CENSUS

NAHB ECONOMIC NEWS NOTES

Housing Starts Bulletin

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NATIONAL ASSOCIATION OF HOME BUILDERS ECONOMICS DEPARTMENT
MICHAEL SUMICHRAST—DIRECTOR NORMAN FARQUHAR—ASSOCIATE DIRECTOR

June 16, 1967

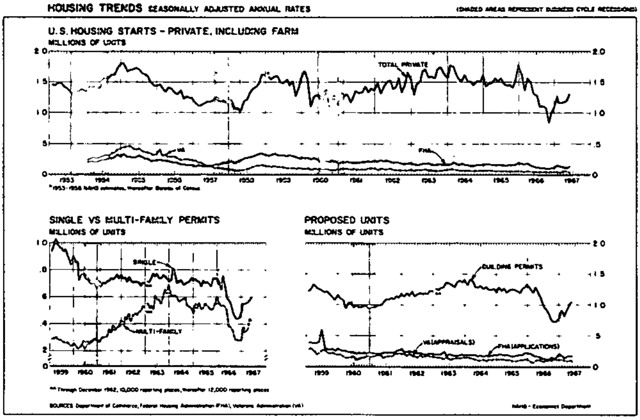
HOUSING STARTS IN MAY SHOW 11.7% INCREASE ...Seasonally adjusted annual rate of housing starts in May was 1,310,000 units, 11.7% above the April level of 1,173,000 and less than 1% below the May, 1966, rate. For the first time in a year a number of the housing indicators are showing signs of promise.

Building permit rates have risen to the highest level since May, 1966; housing starts in the West are at the highest in a year, and single family starts in May exceeded, with one exception, any month since July, 1965.

Continued talk of tight money has been reflected in an increase in long-term interest rates and in the series on conventional mortgage rates as published by FHA. The heavy demand for funds during the first quarter of the year and to a lesser extent the second quarter, coupled with the uncertainty of the money market, undoubtedly did drive interest rates higher. But, this was prevented from becoming a repeat of 1966 by the near record level of savings which exceeded the 1966 rate by 80%.

STILL BEHIND '66 BUT GAP NOT GROWING ...Actual private starts in May were 135,100 units, only 300 units behind May, 1966, starts. The five month starts total in 1967 is 474,300 units, off from 571,600 units in 1966, a decline of 17%. This gap will narrow in the coming months, particularly since activity began to decline in May of last year. If the 1,220,000 level of starts in 1966 is to be achieved, the industry must produce during the remaining seven months on the average of 14,000 units per month above that produced in each of the same months of 1966.

HOUSING TRENDS SEASONALLY ADJUSTED ANNUAL RATES



WEST AND SOUTH STRONGER, NORTHEAST STILL WEAK . . . Seasonally adjusted starts in the West increased to an annual rate of 261,000 units, substantially above the April level of 182,000 and virtually the same as the May, 1966, rate. The South continued its upward trend which began in December, 1966. Activity is now running at the 523,000 unit mark. Building permit increases in both regions indicate likely continuance of this trend. In the North Central the increase in activity has been more erratic -- the May annual starts rate is 338,000 units. While the starts rate showed an increase of 16%, the permit rate declined slightly. The Northeast continues to lag other regions in its recovery. The 188,000 unit annual rate in May is about equal to the very low May, 1966, figure but is not pointing in an upward direction as in other regions. After a healthy increase in building permits in April the May level in the Northeast dropped 19%.

MODEST PERMIT GAINS REPORTED IN MAY . . . The annual rate of building permits in May was 1,046,000 units, 2% above the April level but 5% below May of last year. All of the gain was in the single family sector which rose above the 600,000 unit rate for the first time in a year. Multi-family activity of 445,000 units was virtually unchanged.

NEW HOUSING ACTIVITY
(in thousands of units)

Year	Total Priv.& Public Starts	Private Starts Total	Private Starts One Family	Private Starts Multi-Family	Total Private Starts	Government Programs FHA[1]	Government Programs VA	Bldg. Permits	FHA[2] Applications	VA Appraisal Requests
1959	1553.5	1516.8	1234.1	282.7	1516.8	332.4	109.0	1208.3	369.7	324.0
1960	1296.0	1252.1	994.8	257.4	1252.1	260.9	74.6	998.0	242.4	142.9
1961	1365.0	1313.0	974.8	338.6	1313.0	244.3	83.3	1064.2	236.2	177.8
1962	1492.4	1462.8	991.6	471.4	1462.8	260.8	77.8	1186.6	287.4	171.2
1963	1641.0	1609.2	1020.8	588.4	1609.2	220.0	71.0	1334.7[2]	270.6	139.3
1964	1590.7	1557.4	971.5	585.9	1557.4	204.6	59.6	1285.8	249.8	113.6
1965	1542.7	1505.0	962.3	542.7	1505.0	196.6	52.6	1240.6	237.9	101.1
1966	1251.6	1219.9	793.4	426.3	1219.9	157.6	40.5	966.5	197.0	99.2
	Actual Starts				Seasonally Adjusted Annual Rates					
1966										
May	139.3	135.4	88.1	47.3	1318	128	38	1098	133	98
June	130.7	127.5	83.8	43.8	1285	121	44	954	127	90
July	104.8	104.0	71.3	32.7	1088	117	42	921	124	99
Aug	107.3	105.4	71.1	34.3	1107	113	35	844	119	106
Sept	95.2	92.4	62.3	30.1	1075	96	37	733	151	104
Oct	82.8	80.3	55.1	25.1	848	94	38	714	122	119
Nov	77.6	75.3	50.8	24.5	1012	107	40	715	135	103
Dec	65.7	63.6	40.2	23.4	1089	105	42	759	203	104
1967										
Jan	67.7	65.1	40.3	24.8	1297	150	59	942	157	107
Feb	65.9	64.1	40.2	23.9	1163	139	55	894	135	104
March	97.0	95.5	65.4	30.0	1167	130	58	928	152	103
April	116.7	114.5	76.5	38.1	1173	125	58	1028	162	125
May	137.2	135.1	91.7	43.3	1310	143	55	1046	160	108

Source: Department of Commerce, FHA, VA. 1/FHA annual totals include single family and multiple units. FHA refers to 1-4 family units only. 2/Based on 12,000 reporting places since 1962.

Chairman PROXMIRE. Thank you very much.

Your statement, Mr. Sumichrast, along with the statements by Mr. Paradiso and Mr. Katona, especially suggest to me a real caveat to Congress; and as to the powerful and emphatic recommendation by the Chairman of the Council of Economic Advisers yesterday that he is committed—and it seems that intellectually and logically on the basis of economic statistics we ought to be committed—to a tax increase, I am not so sure that we have gotten that kind of conclusion here this morning.

For example, Mr. Katona, you indicate that the consumer demand is unlikely to be exuberant and, Mr. Paradiso, you certainly indicate some real question about the likelihood of a real upsurge in investment in plant and equipment and you suggest we still have some most serious inventory problems, especially in durable goods.

Mr. Sumichrast, at least you see clouds in the horizon. You see some turnup but not a very big turnup in homebuilding.

Put all these together and where does it take us? I would like to start off, Mr. Katona, with asking you to comment and see if you would agree or if you would shade the statement that was made by Mr. Ackley yesterday when he appeared here.

He said: "It would not be prudent, however, to count on a swift reduction in the saving rate. More conservatively, there are sound grounds for conviction that the saving rate will not rise further. Thus, consumption gains will at least keep pace with advances in disposable incomes."

In other words, he feels that he is not banking on a big upsurge in consumer demand but feels that consumption gains will keep pace with advances in disposable incomes.

Would you agree with that?

Mr. KATONA. I think I would agree with this statement, which is far from exuberant. We have reached unusually high savings rates during the last winter when there were circumstances which had such an impact on the American consumers that a recession was really probable.

Due to various circumstances which I outlined, we have skirted the recession. It did not come. We are in a period of slow improvement. There is still much sluggishness. There is no exuberance, as you, Mr. Chairman, just stated. In other words, we are still in a precarious situation today. Compared to what we had in 1964, 1965, and early 1966, we are not in a good shape.

The consumers are far from confident and they have very many misgivings. Therefore, from the point of view of consumer trends, a further restriction of purchasing power is not indicated, in our opinion, even though I agree with Mr. Ackley that a further increase in the rate of saving is not probable.

Chairman PROXMIRE. With this language of consumer confidence, would this consumer disposition to spend and propensity to save likely be increased by the announcement by the President of the United States that he was pushing for a tax increase? Would people be more or less likely to save?

Mr. KATONA. The tax increase will be viewed as a reduction in purchasing power and therefore as a bad sign for the prospects of the economy. This is clear because today still the beneficial effects of the tax cut in 1964 are well remembered.

Chairman PROXMIRE. Now the President is proposing a significant but at the same time quite a modest tax increase, much more modest than the tax reduction in 1964, a 6-percent cut. Would the consumer be sophisticated enough in your judgment, on the basis of your vast experience, to take this into account and consider that the tax increase would be quite modest and therefore would tend to retard his spending only slightly?

Mr. KATONA. To some extent; yes, and especially because this relatively modest increase has been announced already for some time so that we have already experienced its announcement effect in the past. People got accustomed to this notion. I would expect greater adverse effects on purchasing power if the President were to request a still larger increase in income taxes. This would be an additional shock.

Repetition of the old request and its enactment by Congress would have a much smaller adverse effect on consumer purchasing.

Chairman PROXMIRE. Mr. Paradiso, this committee received a very impressive estimate by Senator Stennis that in his judgment the administration might need another 100,000 troops in Vietnam, and he said this would mean spending an additional $4 to $6 billion. I assume that you are proceeding on assumptions of status quo as far as Vietnam is concerned. If this Stennis prediction materializes, how would this affect your judgment on inventories and on business investment in plant and equipment, and so forth?

Mr. PARADISO. I think it would affect inventories of the companies producing defense products. Their inventories would rise.

Chairman PROXMIRE. I would like to put this in the perspective of what has already happened. We had such a stunning escalation more than a year ago. It was sharp, but had a very clear and emphatic effect on the economy, but we are at a pretty high level now.

It would seem to me that as you get an increase of $4 billion to $6 billion above what we have now, it would be less in proportion than the increase of from $10 to $20 billion that we got before.

Mr. PARADISO. That is correct; but, nevertheless, there would be some further purchases of materials and supplies, and work in process would rise. This is going on even now. The May report, for example, shows that there has been an increase in these inventories held by these companies producing defense products, but other companies are also affected and they perhaps might not want to reduce their rate of accumulation, nor even try to liquidate. In other words, any further increases coming from the Defense Department would make some of these high inventories not look too high because of the expectation of rising sales to the Government.

Chairman PROXMIRE. It would seem to me that Congress might have some reason to consider the wisdom of a tax increase as to whether or not the President does ask for an additional commitment in Vietnam. If he asks for an additional 100,000 men in Vietnam, it may well be that we should go ahead with the tax increase. If not, it would seem to me that the economic case is not as strong.

Mr. PARADISO. There are two phases to this. One, if you increase the tax, is the purpose to cool down the private demand or is it the purpose to reduce the deficit?

Chairman PROXMIRE. I would take the former and ask you to speak to the former.

Mr. PARADISO. For the former, then, this depends on the way the economy will move ahead in the coming months because, if the economy turns out to be exuberant, I think a tax increase would not do very much damage.

On the other hand, if the economy should turn to continue to be sluggish, then there is a real question from the economic point of view. I think Mr. Katona has stated very clearly that you would have a reduction in the real purchasing power.

Chairman PROXMIRE. I don't mean to interrupt except that I want to make sure I understand. You feel that there is a possibility that even if we do have expansion in Vietnam, it is possible that the economy may continue to be sluggish, you may still have enough resilience in the economy so that you don't have this pressure on prices and interest rates that we are all so fearful of and want to prevent?

Mr. PARADISO. This question is more complex than that. The price question hinges on what will develop in the farm area and this is very important with respect to food prices. It does appear now that the food prices may not go down as they have in the last several months and that there may be a firming up. With regard to industrial prices there are problems.

Chairman PROXMIRE. Food prices are not going to be affected much by fiscal policy anyway, are they?

Mr. PARADISO. It is a consideration by the consumers with regard to what they will do. In connection with the industrial prices, here the problem is to what extent can the producers offset higher costs. This depends on the competition, the extent of competition, and simply what they get with regard to productivity. The problem here is that they will attempt to maintain their profit margins if they can. I think there is a real problem here with respect to the price trend. Just because the private economy should continue in a sluggish pace—and I am not saying that this is so—in my statement I indicated that there would be an acceleration.

Chairman PROXMIRE. You are putting it very well. I should have confined my questions to the effects on demand, the fiscal effects of the policies we are talking about rather than what is actually going to happen to prices, which I realize are a function of a lot of other things, including weather, including what happens in this very complex agricultural economy we have.

Mr. PARADISO. I simply repeat that if the economy accelerates in the second half, I don't think that the fiscal effects will be very damaging. I don't think there will be much effect coming from that. On the other hand, if the economy continues to be sluggish, then I am really very much concerned.

Chairman PROXMIRE. Unfortunately, I have to leave. Before I do, I would like to ask Mr. Gaines this question. In your judgment, Mr. Gaines, because you are an expert in the monetary area and the effect of all this on the interest rates, if we do not increase taxes and if we have a substantial deficit, $15 billion or $20 billion, would it be feasible for the Federal Reserve Board to follow the policy that you suggested here of keeping interest rates down by open market operations—long-term interest rates down at least?

If the economy continues to be as sluggish or stable, however you want to put it, in spite of the big Federal deficit, technically what problems develop when you try to adjust this way?

Mr. GAINES. Yes, I think a direct answer is that it would be feasible. The problem that the Federal Reserve has run into so far this year is simply that the textbook system of pumping reserves into the banking system and thereby having an effect all through the rate structure has not been effective. There is not an easy flow from short-term to long-term markets, and the pressures in the first half of the year have been on the long-term markets.

Consequently, if they would continue to supply long-term funds directly, buying Government bonds from the market, this program I believe could put a ceiling on the extent to which long-term rates might rise, although I do not think the Federal Reserve would wish to push it so far as to drive rates down from present levels.

It is a matter of supplying long-term investable funds directly to the market rather than indirectly through the banking system. This could be done with no change in their underlying policy with respect to the funds supplied to banks, growth in money supply, and the rest of it.

On the other hand, I see no escape from significant upward pressures on short-term rates during the rest of this year. I believe that my estimate of $20 billion of Government borrowing during the last 6 months is well within the ball park, give or take a billion dollars or two on either side.

This pressure of demand, even though it may be offset on the other side by the net cash expenditures of the Federal Government, will be difficult to service simply because of the frictions that exist in the financial system in translating net expenditures from Government into the availability of investable funds in the financial markets.

My serious concern, then, is that short-term interest rates might be driven up again to a level that would cause the withdrawal of savings funds from the banks, and lead to the increase in the policy loans of insurance companies and all the rest that we saw last year.

Were this to happen, if, in other words, short-term rates were permitted to rise to these levels, we would have a most complex situation. I would not attempt to predict the way the financial markets would work their way through this process.

I would like to add that we are not too far from this disintermediation level at the present time.

I mentioned in my remarks that yesterday's auction of 1-year Treasury bills went at an equivalent rate of 5 percent. That means that agency borrowing by the Home Loan Banks or FIC would today have to be around 5¼ percent.

At that level, equal to what savings and loans are paying on their savings certificates and in excess of what commercial banks are paying, we are quite close to the point where disintermediation could lead to the problem I am concerned about.

Chairman PROXMIRE. I wish I could stay but, unfortunately, I must leave. This is a wonderful panel. I think you are doing a most enlightening job.

I am going to ask our ranking minority member, Congressman Curtis, to chair the committee.

Representative CURTIS (presiding). Thank you, Mr. Chairman.

Let me add my expression of appreciation to this panel, and let me compliment our committee staff for getting such a well-balanced and distinguished panel. This is not an easy thing to do. These papers clearly are to their credit, as well as to the credit of the panel itself.

I am going to make this observation. This is one of the few times, if not the only time, I have seen presented to us the problems involved in Federal debt management. It's a dialog that has failed to develop over a period of years in the Congress and in the general public. It is a dialog that should occur when the House and Senate consider the debt ceiling, when we should dig into the very points that are being presented to us today.

Now, I would like to pose some hypothetical questions. I think we have to accept the administration's figures of yesterday, with proper interpolation. We are talking about a deficit of $23.9 billion. Yesterday the Chairman of the Council of Economic Advisers said that, taking the Bureau of the Budget's estimates, the deficit for fiscal 1968 was $13.4 billion. But this was on the assumption that we were going to get an additional $5.5 billion from new taxes.

It was also on the assumption that we were going to sell $5 billion of participation certificates. As a matter of simple arithmetic, we are talking about a deficit of $23.9 billion without even considering the contingencies of increased spending for Vietnam or other contingencies causing a shortfall of the revenue estimates.

The question that is before us is: How do we finance a deficit of $23.9 billion? We can finance $5 billion by selling participation certificates, but that has an impact on the money market. In fact, the sale of participation certificates last year was cut back, as I understand it, because it was felt the impact, particlarly in the housing field, would have been deleterious. So even though the administration had the authority, it did not use it.

Congress already has cut back on the administration's request to sell $5 billion worth of participation certificates this year. What power the administration will end up with, I don't know; but, even so, this is a part of the financing of the deficit.

Now, will the financing of a deficit of $23.9 billion (in whatever mix we decide of sale of capital assets, increased taxes, and the sale of new Government obligations) in the present economic climate, create inflationary forces which will show up in the Consumer Price Index?

Anyone who would venture a comment on that may answer. In other words, is this creating inflationary forces? Possibly there are ways of handling it. Maybe we could go to the extreme of wage and price controls, but does this sizable deficit in the present economic picture create inflationary forces that are likely to show up in price increases in the ensuing months?

Mr. GAINES. I am perhaps less qualified than the others to speak on the price indexes, but this is in response to the chairman's earlier questions to the other panelists.

I would think that even given the relative slack in the economy thus far this year and even assuming no substantial boom, that one has to ask the question as to how much fiscal stimulation is required in the type of economic setting that we have.

I would judge that a $24 billion deficit—the magnitude you mentioned—on an administrative basis, including the FNMA financing which translates perhaps to a $20 billion cash deficit and something in the order of $17 billion or $18 billion on the national income basis could ultimately build a base of purchasing power within the economy that could next year perhaps, or at some time in the future, generate the type of inflationary difficulties that you ask about in your question.

If the private economy were to continue relatively slack during the balance of this year in spite of a deficit of this magnitude, we might not have too much in the way of demand-pull type inflation on the economy, but I would think ultimately there would be an effect upon price indexes from this deficit.

Representative CURTIS. Thank you.

Would anyone else care to comment?

Mr. KATONA. I would answer in the affirmative. Some effect of a large deficit would show up in the Consumer Price Index. But the question is not stability versus increases. Our hope is that during the next 12 months price increases, the increases in the cost of living, should be kept below what they have been in the past 12 months.

This, if it could be achieved, I would consider satisfactory. In other words, some price increases I take for granted, and they need not have a bad effect generally speaking. There is a hope that during the next 12 months, in spite of everything, price increases may be kept at a lower level than in the past 12 or 18 months.

Representative CURTIS. I would interject this. To some degree, though, as the result of the inflation of 1966, and with the number of labor-management agreements coming up this year, we are threatened by some of the cost-push kind of price increases. I don't know how big an element that is, but would you agree that it is a factor?

Mr. KATONA. That is a factor. Clearly we can't predict how large the average wage settlement will be. The wage settlements which are viewed by the people as large or substantial have both beneficial effects and adverse effects, the adverse being when prices go up and create inequities.

This is a very important question as to how large the major, well-publicized wage settlements will be.

Representative CURTIS. Thank you, Mr. Katona.

Mr. Paradiso?

Mr. PARADISO. I would agree that not over the short term, but in the longer run this sizable deficit would create a base of expanding demand effecting a demand-pull type of price inflation. In addition to that, you would have also the cost push, and this would be pretty bad.

Mr. SUMICHRAST. Of course, funds into thrift institutions——

Representative CURTIS. I was going to get to that as a second part.

Mr. SUMICHRAST. Go ahead.

Representative CURTIS. In the sequence of questions I was going to ask, first, on the Consumer Price Index; second, how shall we handle the deficit? how much Government bonds? how much tax increase? and how much sale of PC's? If that is an element, and what the different mix might produce; and third, what would the effects of this mix be on our financial markets and interest rates and housing. So I may be anticipating what you are about to say.

I was interested right now in at least finding out on the Consumer Price Index.

Mr. SUMICHRAST. I think there would be an effect on the prices which probably will show up sometime later this year or next year because the economy isn't really going anywhere very fast. As I said already, the concern about the deficit is mainly what will this do in the money markets if the Government has to raise money and compete with us and everybody else for it.

Representative CURTIS. Go ahead and comment on it.

Mr. SUMICHRAST. This is the major concern of ours because if a deficit is going to be large and if the Government is going to have to raise a large amount of money and if Mr. Gaines is correct in saying that the short-term money markets are going to be firmed, this would mean virtually a turnaround in the flow of savings into the savings institutions or at least the rate of increase will slow down considerably.

Right now the flow of funds is very high, but there is a problem of repayments. I am talking here about savings and loan associations. They repaid about $2½ billion in the first 2 months of this year. They have to build up their liquidity so that we need the second half to get further funds into thrift institutions.

If we don't get it, I would guess that we will have to face another similar situation as we had last year.

Representative CURTIS. Let me ask this, and then go back across the panel. The mix that is presently in the budget message is $13.4 billion to be financed by new debt securities, $5.5 billion by new taxes, and $5 billion by sale of participation certificates. Suppose, instead of selling $5 billion in participation certificates, we had $18.4 billion of new debt securities and $5.5 billion of new tax revenues. Would that ease the picture at all, or would that tighten it, and make it worse for the housing industry?

Mr. SUMICHRAST. Well, any tax increase, of course, will not help us.

Representative CURTIS. It would or would not?

Mr. SUMICHRAST. It would not help the buyer. As Mr. Katona already indicated, individual disposable income gets smaller so that there may be a tendency on the part of the consumer to postpone purchasing. However, the situation is not clear at the present time, and I don't know whether anybody really knows what will happen in the second half. If the predictions are correct——

Representative CURTIS. Wouldn't it ease the problem in interest rates in the finance market to have less of the deficit financed by new Treasury certificates?

Mr. SUMICHRAST. I think what we need is a mix of fiscal and monetary policy. What form this will take I don't know. The situation is not very clear to us. The only concern we have is that we have mortgage money available and either way you slice it, it all comes out of the one pool of funds which we have; namely, household and corporate savings. If the Government is going to be there raising money and the corporations are going to be there raising money, the mortgage market, being a residual market, never has the same power to attract capital the way other segments of the economy have. So that this is our concern.

What will happen to yields in the short-term market will eventually determine what will happen to the flow of funds to the savings and loan institutions. This is what we are concerned about.

Representative CURTIS. Let me ask Mr. Gaines this general question. But first, to be specific, is it true that it does make a difference whether the Federal Government issues $5 billion in new debt securities or sells off $5 billion in participation certificates because it would go to a different market?

Mr. GAINES. Yes, sir.

Representative CURTIS. What do you think about the impact of the mix, of how we might finance a $23.9 billion deficit on interest rates? If we financed the whole $23.9 billion out of Treasury securities, that would create a greater burden on interest rates, would it not, than if we got $5.5 billion out of new taxes and another $5 billion out of participation certificates?

Mr. GAINES. Certainly the tax increase would help to alleviate the pressures on the credit markets, for obvious reasons. It would reduce the amount of financing the Treasury has to do. The answer is not quite as clear cut as between using direct Government debt or the participation certificate route.

The bulk of the participation certificates that have been sold have been longer term. If there is a logical reason for the Treasury using this route, it is to avoid the 4¼-percent ceiling on Treasury bonds. If we assume that the larger part of the participation certificate financing would be in the 10- to 15-year range, that would compete directly with the other institutions, including the housing industry, that are seeking long-term funds and to that extent would have a direct upward pressure upon the longer term interest rate structure.

On the other hand, if there were no participation certificate financing and that $5 billion took the form of direct Government debt, one must assume that the securities the Treasury would use would be shorter. This would put upward pressure on short-term market rates, which could then lead to the problem of the withdrawal of savings funds out of the various institutions and thereby reduce their ability to take on long-term commitments and indirectly lead to almost the same result as selling the long-term securities directly to the market.

There is no answer to what the net effect would be. I think the simple answer is that there is too much debt to be sold, and whatever form it takes, we are going to have serious problems for the housing industry and the credit markets.

Representative CURTIS. You see the problem presented to the Congress right now. Mr. Martin, the Chairman of the Federal Reserve Board, said we ought to move forward to a tax increase now and that it should be even greater than the 6-percent surtax; in other words, we should finance more than the $5.5 billion of the $23.9 billion deficit out of new revenues. Mr. Mills, the chairman of the House Ways and Means Committee, during the debate on the debt ceiling expressed this view somewhat along the line of the view of Chairman Proxmire.

He said:

> I would consider a tax rate increase if I thought we were going to get more revenue, but if increase in the tax rates was going to have a deleterious effect on the economy, we could end up with less revenue.

So here is the fiscal problem that is put in the lap of the Congress. This is not for comment from this panel, but the Executive gives the Congress and the people no advice and just tosses the problem out, saying, "Do what you please with it," without giving us their judgments on the proper timing of the tax increase.

Now, if the panel would comment on what, if any, increase in taxes the Congress ought to enact to ease the problem that otherwise would be created in the money market, I think that would be helpful.

Mr. KATONA. The studies about the probable forthcoming consumer demand in the second half of 1967 suggest that there is, first, no reason for enacting a tax increase right away; it can be postponed.

Second, there is no reason to finance a substantial part of the deficit through higher taxes. The 6-percent proposal I consider as the maximum which is tolerable for consumers who do not contribute much to the inflationary pressures today. The money market situation, Mr. Curtis, should not be used by the Congress to penalize American purchasing power in my opinion.

The 6-percent increase has a very great advantage that people more or less have become accustomed to that figure so that it wouldn't be a new shock if and when it is enacted later this year, whereas any increase in the rate would indicate that there are some new danger signs, some new trouble, some new disturbance which we, the people, haven't been aware of before. The money market problems ought to be solved without a larger tax increase.

Representative CURTIS. Thank you.

Mr. Paradiso?

Mr. PARADISO. Mr. Curtis, I don't know as I should comment on a policy matter of the administration.

Representative CURTIS. Let me ask you a specific question, if I may. Isn't it true that plant and equipment spending by large firms is rising this year, but that by small firms is falling?

Mr. PARADISO. This is true.

Representative CURTIS. Wouldn't then the borrowing to finance a large deficit make this disparity even worse?

Mr. PARADISO. I think that is also true. There is one benefit, however, that I believe the small firms have, one incentive that they have already obtained, and that is the reinstatement of the investment tax incentive.

The small firms 3 months ago were projecting a very substantial decline this year and in the June survey apparently they are not projecting anywhere near that kind of decline, so that I think the investment tax credit is going to be a help to them.

Representative CURTIS. Thank you.

Now, to present to the panel the problem facing the Congress for decision, we are talking about a deficit, according to the administration's own figures, of $23.9 billion. With the Vietnam war contingencies, it is likely that there is going to be at least a $5 billion increase in the deficit. In fact, the House Appropriations Committee in debate on the Defense appropriations bill gave us a figure of $8 billion. This has led me to say to the administration, as best I could, that they should plan to cut back on nondefense expenditures enough to give us a $23.9 billion deficit to finance instead of a $29 or $30 billion deficit.

Would anyone care to hazard a guess as to what financing a $30 billion deficit might mean? To put the situation in proper context, remember that the administration has said, "Well, if we cut back nondefense expenditures of $5 billion, that has an economic impact, too," and of course it does. This would hit the investment market, I would think. I would also think it would hit very much the Consumer Price Index in an accelerated way.

Would anyone care to comment?

Mr. GAINES. I would comment that if your $30 billion administrative deficit were to prove to be right, including participation certificates, I think the problems in the financial sector of the economy would be unmanageable short of direct controls. The Federal Government has been able to finance larger deficits than this in the Second World War in a setting of direct controls. I would hope that this would never be necessary in what we still consider as relative peacetime.

I would also like to differ with Dr. Katona's position on the tax question. It seems to me that the size of the deficit—whether it is the $24 billion deficit without a tax increase, the $19 billion deficit with a tax increase, or the $14 billion deficit X-ing out the PC part of the financing—given the basic health of the economy, is well in excess of what is required from fiscal policy to operate responsibly in maintaining a growing economy.

I would be very strongly in favor of adoption of the 6 percent tax increase at the earliest possible moment, without regard to the slight drag this might exert on the private economy. Were the tax to be enacted effective October 1, the administrative deficit, instead of roughly $14 billion after X-ing out the various factors, would be of the order of $12½ to $13 billion. This would translate to perhaps an $8 billion national income accounts deficit, which I believe is an adequate contribution for fiscal policy given the basic health of the economy.

Secondly, if defense spending were to increase by any of the amounts that are mentioned, and it is my understanding that this is a decision that has still not been taken, I would hope that the tax increase would be scaled up accordingly to deal with this increase in Government spending. I speak from something of a biased position because of my position in the financial market, but I am very seriously concerned about the orderly functioning of this important sector of the economy if the type of financing has to be done that would be implied by deficits of the order that have been mentioned in some of the figures that I have seen.

Representative CURTIS. Thank you very much.

I might say that my analysis is quite close to yours, as I understand it, and somewhat similar to that of my colleague, Mr. Mills. I have said that I would be for a tax increase but I predicate it on that politically difficult factor that you refer to, namely, cutting back nondefense expenditures. If we have deficits the size of $30 billion, arguing about the mix of how much new taxes, how much deficit, how much selling off of capital assets frankly doesn't make too much difference.

The deficit itself is the problem and so I have coupled it with the need to cut back nondefense expenditures. This is not for this panel but for the record. The political problem of cutting nondefense expenditures could be resolved very quickly if the President of the United States would pose the fiscal problem straightforwardly to the people through his agents, the Director of the Budget and the Secretary of the Treasury. If it were presented to the people and the Congress, then there would be an inclination on the part of Congress not to grant these increased requests for spending. Indeed, if the President would tell the people, "It is time to tighten our belts," I think there would be a response. Instead I have heard that he still whets the people's appetites for these domestic spending programs. The Members of Congress have a right to think the President is leading us correctly and that, therefore, we don't have to worry about this area of nondefense spending. Here is the political aspect of the problem.

Let me get back now to the economic picture as best I can understand it. This question is to you, Mr. Gaines. I think one of the most startling figures that has come out has been in the balance of international payments. On the liquidity basis for the first quarter of 1967 the deficit was minus $2.1 billion dollars but on the official reserve transaction basis it was $7.3 billion. This is a most amazing figure, although one which in some respects many of us had been predicting, because the surplus shown for the year 1966 came from a lot of short-term money coming into the United States that could go out just as fast.

I am interested in your analysis of this figure as it relates to the problems that you have presented to us in your original paper concerning the availability of funds in the short-term market, the likely future interest rate levels, and so forth.

Mr. GAINES. Your analysis of the reason for the very large first quarter figure is correct. It is an offset to the $2½ billion or so that U.S. banks purchased in the Euro dollar market in the last half of 1966. With lower rates and availability of domestic funds commercial banks were able to repay a good part of the foreign borrowing and rely upon the domestic market to take care of their needs.

I would not expect that figure of $7 billion to hold through 1967. Much lower figures are likely.

Secondly, on the effect of our domestic financial problems on the balance-of-payment figures, the credit pressures that I see ahead will at least superficially tend to improve the reported balance-of-payments statistics. To the extent that our short-term interest rates rise significantly, and assuming that the Bank of England is not prepared, given its economic difficulties, to raise the bank rate, we could either slow down flows of short-term funds out of this country or attract funds from abroad.

Representative CURTIS. If our interest rates go up?

Mr. GAINES. Yes. There is another aspect to this, however, that I think is really quite significant. I have indicated that I doubt that Mr. Wilson would wish to raise the bank rate in England to counter a loss of funds because of high interest rates in our own markets here. However, failure to do so could create most serious problems for the pound so that we might find ourselves confronting a situation where because of rising rates in our markets we might force a domestic policy upon the United Kingdom, that is, higher rates in their market, or find ourselves putting the current value of the pound in jeopardy.

So that whereas I think that the credit squeeze domestically will tend to improve our balance of payments I think it could have effects upon our friends in the United Kingdom that we do not wish to see happen.

Representative CURTIS. Do you feel that this is in any sense creating a crisis in the international finance picture considering the position of the dollar as the basic medium of exchange?

Mr. GAINES. I don't really see any crisis problem unless the worst should happen in our relationship with the United Kingdom.

Representative CURTIS. Doesn't the dollar go with the pound if the pound goes?

Mr. GAINES. Yes, I think realistically we have to assume that the United Kingdom presently is on a dollar exchange basis in any case. I believe that what would happen if we were to create the problems that I have suggested would be that the United Kingdom would begin to reuse some of the lines with our Federal Reserve System that they have repaid in recent months because of the nice flow of funds they have had.

Representative CURTIS. Another problem is that if interest rates go up here that means increased costs of credit, and, of course, the same thing that is forcing up the interest rates will be forcing up the Consumer Price Index. Increases in prices, in turn, put our exports at a disadvantage and imports at an advantage. Then we lose our basic asset in the international balance; namely, our favorable balance of trade.

Would you comment on that picture? In other words, when you have to look at the whole fabric, I think you find we are running out of cloth. You pull it to cover one part of the table and you pull it off other parts of the table. I wonder if we are not reaching this point. Maybe one wouldn't call it a crisis. I do. I think it is a serious crisis. I don't know how we are going to pull this cloth any more. On taxes people say that if you raise them you have an impact on the economy, and I think our tax rates are still too high. Yet if you go to the other source and try to borrow more money you create additional problems there. I think we have a similar picture internationally.

Mr. GAINES. Yes, sir. Unquestionably rising prices domestically do have adverse effect on our exports. Also if some of the forecasts of a very rapid business expansion later this year and into 1968 should be true this would have an even more profound effect on our imports, having very harmful effects on the balance of payments.

I find something a little bit amusing. In recent years we have taken to lecturing the Western European countries to make more effective use of fiscal policy and not rely exclusively on monetary policy to deal with their domestic problems. I don't know that we are in a very pristine position currently to be giving lectures of this sort to our friends abroad.

Representative CURTIS. I thank you, sir. Finally, I just have some questions to inform myself.

I was rather startled in reading a statement in one of the bank reviews that a good bit of the financing in 1966 had occurred outside the financial institutions. I have forgotten the term used but I believe it was household financing, at least from the private individuals. I find that a lot of people who could borrow on their insurance policies for various reasons did so because they would get lower rates. The main thing is to develop institutional financing.

Could you give me some insight as to what the household financing was in 1966 in these terms? I guess it means banks, and savings and loans, but not pension plans, although it could. What is that picture? Can you help me a little?

Mr. GAINES. In my table 1, which is a summary of financial flows derived from the Federal Reserve flow of funds data, in the bottom two lines on sources of credit, private credit market instruments and other, the catchall, you will notice that in 1966 the total was some \$21.7 billion which compares with \$8½ billion the year before and similar amounts in prior years.

This reflects the shift that you refer to. The very simple explanation was that, as the banks for cooperatives, the Federal intermediate credit banks, the U.S. Treasury itself found themselves paying 6 percent, 6¼ percent for money, a growing number of smaller savers discovered that the 4 percent they were getting at their commercial banks or the 4¾ at the savings and loan associations were not really very attractive rates of interest. They became more sophisticated investors, let's say, and withdrew funds from the regular savings intermediaries and bypassing the established financial system went directly into the securities market.

There has been a bit of reversal of that, quite a reversal of that this year. A good part of the rapid growth in reported time and savings deposits at financial institutions has been a reversal of this flow, a one-shot recapturing of this money. I expressed my concern earlier that, now that we have educated the saver as to the availability of other instruments besides a passbook savings account or savings and loan share, were short-term market rates to rise again to any point close to last year's levels we would see a beginning of this movement once more.

I might add that the life insurance companies, which for years had regularly made about $50 million per month in loans against policies, saw that figure jump to about $150 million per month during the last 6 or 7 months of last year, a most serious drain on their resources. That has not settled back to the $50 million level but has been running month by month around $100 million. I think it is a good illustration of the way that the typical consumer or saver, once he becomes educated, does not revert to the simple way of saving that he used before. He has discovered that he can borrow money at 5 percent against the cash value of his life insurance policy.

This is one of the most serious problems we face in the months ahead, because this money pulled out of the banks, insurance companies, and savings and loan associations is almost without exception used by the small investor to buy short-term obligations. He has had his money in a savings account in the past because he has virtually immediate access to it. The savings institution, had it kept the money, would have used it to buy mortgages or longer term investments, but the saver when he pulls it out of the institution uses it to buy short-term——

Representative CURTIS. In other words, this is an indication of a shift from long- to short-term investment.

Mr. GAINES. Yes, sir.

Mr. KATONA. May I object to the expressions. "small investors," "typical savers"? Our studies indicate that it is almost exclusively high-income people who make use of these things where they think of borrowing at 5 percent and investing at 6 percent.

Representative CURTIS. But take in the life insurance companies' experience?

Mr. KATONA. Including that. The typical person or, put it that way, the majority of American savers and middle or lower income people don't make use of it. So that we have a question of social injustice. The high interest rates serve only the relatively well-to-do people in America, and the typical person does not profit from those rates.

Mr. GAINES. I accept the correction and agree with it. In our own institution, we saw that most of the withdrawals from our savings department were the $25,000 or larger withdrawals.

Mr. KATONA. Which the typical person doesn't have.

Representative CURTIS. Mr. Katona, I deeply appreciate this elucidation. To me, it stresses that what you have said was true in the past, but hasn't there been a shift? Aren't the smaller investors beginning to find out about this? This life insurance shift illustrates this. It consists of millions of policyholders who have suddenly learned—and I have talked to some as individuals—that they could borrow money at whatever their rate was in the policy and then put it immediately into some of these short-term higher yield investments without risking anything.

I don't know this is so. I just thought it was an important phenomenon to investigate. You have already answered my second question; whether you thought it was going to continue. This is a very interesting thing.

Let me ask a final question. Noticing in the disposition of personal income that, in the fourth quarter, savings went to 5.9 and then, in the first quarter of 1967, jumped to 6.5, is this to some degree reflected in this? Or do you think there is some other economic reason why the incidence of savings has gone up? I note on this table that there are savings back in 1958 of 7 percent, so that it is still within the context of our history.

Mr. Paradiso. I think this is partly reflecting that, but I think it is also associated with the low rate of automobile purchases. The first quarter rate of automobile purchases, as you remember, was especially low; and with some pickup in auto sales in the second quarter, the rate of savings has been reduced, as we can see now from the preliminary figures. But it is also partly this phenomenon of people just taking their money and getting some high interest rates out of it.

Mr. Katona. As Mr. Paradiso said, there was a high rate of postponement of discretionary purchases and expenditures on the part of consumers during the fourth quarter of 1966 and the first quarter of 1967. This is reflected in the high saving rate, but on the whole I believe there are very good reasons to think that our saving rates will continue to be fairly high, except for unusual inflationary conditions, which I do not anticipate.

The desire to save, the desire to build up reserve funds, is very pronounced among the American people. They know that they have a much higher standard of living today than some years ago. They aspire to have a still better standard of living, but at the same time they do think that the future is uncertain and that it is important to have reserve funds.

Therefore, although the saving rates last winter were unusually high, I do not expect them to fall sharply.

Representative Curtis. I wonder if this is a reflection somewhat of the picture in housing. In your paper you point out that the demand is there and that possibly people are not moving into the market, but are saving up. Would you comment on that?

Mr. Sumichrast. In addition to what Mr. Paradiso said, I think the effect of more savings is quite clear in the rate itself. When you look at what happened after the mutual savings banks raised their rate last fall to 5 percent in five city banks, then you can see the increased flow of money. This is the money which goes from coast to coast looking for a higher yield, which has been responsible for the flight of money into credit and equity instruments last year. This was phenomenal. When you look at the first quarter, the figure was about $2 billion, and it went to about $12 billion in the last quarter, with people looking for higher yield and getting better returns on the money.

When savings and loans became competitive, the money started to roll back again. As I already said, our concern is basically that this flow will not be reduced. We hope that it will not, but as I already said, if it should be, then we will be in a very unfortunate situation again, because we need the second-half flow of funds to continue at some high level.

Representative CURTIS. Mr. Paradiso?

Mr. PARADISO. I would like to get some clarification from Mr. Katona which bears on this problem of the consumer spending in the second half of the year, and which also is related to the tax problem. I don't think there is any difficulty in getting a very substantial increase in consumer spending in the second half. I think what you are really asking is not the total consumer expenditure, as I understand your survey, but that you were really talking about a relatively small percentage, 15 percent of consumer spending, related to the consumer durable goods sector.

If this is so, consumers have been spending on nondurable goods amounts which were quite consistent with their disposable income, and as far as their expenditures on services are concerned, they have been rising steadily for many, many years, and that increase is continuing. So that when you consider the totality of consumer spending, it is not difficult to get an $8 billion or even a $10 billion rise in any particular quarter.

The sluggishness in your surveys comes from spending for furniture and electrical appliances and automobiles. Am I correct on that? Because I don't find it difficult to get a large increase in consumer spending.

Mr. KATONA. I would take objection to the 15 percent figure. The Federal statistics only differentiate durables, nondurables, and services. Discretionary expenditures, expenditures on things people like to have rather than must have, are much larger than 15 percent. There are innumerable services, very many aspects of leisure-time expenditures, et cetera, which are not separated well in our Federal statistics. The volatile element is represented by the discretionary expenditures, and especially the durable goods expenditures, with which we are most concerned. It is true that expenditures for necessities follow income pretty closely, as you said.

The only thing I would like to add, if I may, is that our data indicate, as has been mentioned here before, that needs for new housing, wants and desires for new housing, far outrun today the actual purchases and the expressed intentions to buy homes for owner occupancy.

There is still, as was clearly in 1966, a retarding effect of tight money. I think if this continues over a long period, much dissatisfaction would ensue. If it is true that interest rates would rise, as Mr. Gaines indicated, if it is true that tight money is with us for a long time, some measures are necessary to facilitate the flow of funds into the housing market.

Representative CURTIS. Thank you very much. I want to again thank the panel in behalf of the committee for a very splendid presentation. I know this material will be of great value to all of us.

Tomorrow the committee will meet at 10 o'clock in this same room, at which time we will hear Professor Paul Samuelson, Department of Economics at Massachusetts Institute of Technology, and Professor Fred Weston, Department of Economics, School of Business, University of California at Los Angeles.

Thank you again.

The committee is adjourned.

(Whereupon, at 12:10 a.m., the committee adjourned to reconvene at 10 a.m., Thursday, June 29, 1967.)

ECONOMIC OUTLOOK AND ITS POLICY IMPLICATIONS

THURSDAY, JUNE 29, 1967

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

The joint committee met at 10 a.m., pursuant to recess, in room 1318, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senator Proxmire; and Representatives Reuss, Widnall, and Brock.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority economist.

Chairman PROXMIRE. The committee will come to order .

Today we are holding the third session of our current hearings on the Economic Outlook and its Implications. As I indicated on Tuesday, we expect to hear from the Bureau of the Budget as soon as they complete their revised forecast for fiscal 1968.

We have heard from the Council of Economic Advisers and from four highly competent economists, each of them a specialist in an important sector of the economy.

Today we are privileged to hear from two of the Nation's outstanding economists, Prof. Paul A. Samuelson of the Massachusetts Institute of Technology, and Prof. J. Fred Weston of the University of California at Los Angeles. They are eminently qualified to help us explore the state of the economy, both present and prospective, and give us some guidance on policies to be followed.

Gentlemen, I would like to just say two more things. One is that I apologize for the fact that other members of the committee are not here on time and that quite a few unfortunately can't be here today at all. As you know, this is the last day before the recess. It is a recess lasting until July 10 for both Members of the House and Senate and it is understandable that they take advantage of this to leave town as soon as they can. I am sure that there will be other members here.

The second point I want to make is that I see in his prepared statement that Professor Samuelson has given the Government economists a B-plus grade. However, every time you appeared I believe you rated a substantially higher grade than that.

At this time, without stretching the analogy too far, I want to say that I do wish you had gotten your statements to us in advance. We have a rule that witnesses' statements are supposed to come to the committee 48 hours in advance. Our questions to you are formulated to some extent on these statements. Therefore, we appreciate any opportunity to think about and prepare thoughtful questions based on what you have told us in these statements. I only emphasize this because both of you gentlemen appear before this committee fairly often and it would be very helpful in the future if you would supply to us your statement—amend it any way you want but just see that we have a basic outline—before you appear, so that we can work with the staff to prepare thoughtful questions.

Professor Samuelson, you may proceed.

STATEMENT OF PROF. PAUL A. SAMUELSON, DEPARTMENT OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Chairman, it is a pleasure to appear at this seminar. I want to plead guilty to an unpardonable crime in a professor-absentmindedness in not getting my statement here in time. But let me proceed with it.

In my academic way I give grades at this time of the year and I have given a B-plus to Government administration economists.

President Johnson and his economic advisers have been generally correct in their forecast that the first half of 1967 would be weak—but not recessionary—and that the second half of the year threatens an economic advance that could be excessively inflationary.

Prudence also requires me to agree with their view that taxes may have to be raised late in this year, both to help restrain aggregate spending that threatens to become excessive and to permit the Federal Reserve to keep money and credit from becoming tight enough to abort the construction recovery and to cause liquidity problems for our savings and loan and other important institutions.

Why don't I give them an A?

Well, although *qualitatively* right, the administration was *quantitatively* overly optimistic in its January forecast of the strength of the private economy in 1967. Real GNP will not grow by 4 percent this year, as they have predicted; and, if Congress had enacted the 6-percent tax surcharge at the recommended July 1 date and had held Government spending to the budgeted levels that the administration gave in January, real output would grow considerably less than the estimated figure.

But if the facts make the administration economists look less than perfect, their critics—many of whom testified before you in February or had infiltrated the membership of this committee—make the Council of Economic Advisers look like well-informed, competent professionals.

Example: that inevitable recession which was supposedly deducible for 1967 from the contrived drop in the money supply during 1966, engineered by the cruel Federal Reserve, has not happened. The word "minirecession" has had to be invented to save face of those who made such confident predictions. Most of the "new economists" no longer in Government—I have in mind Heller and Tobin who testified before you in February and your humble servant who was on sabbatical—have so far proved right in modifying downward the CEA forecast but adhering to its qualitative outlines. I should add that expert "old" economists, like Arthur Burns in his February testimony before you, also can claim that events have materialized about in line with his enunciated expectations.

Another example why the Government economists must be given a high grade is that many business economists believed that the Council of Economic Advisers was exactly topsy-turvy in its expectation: instead of a weak first half of 1967 followed by a strong second half, these economists predicated for you a strong first half to be followed by a weak second half. Those of you who quoted such authority against the CEA turn out to have backed the wrong jockeys.

I don't know whether the indulgent moderator of the seminar has turned the page but——

Chairman PROXMIRE. If you had been more prompt in supplying us with this, I would have probably made a different opening remark because I could have turned the page.

Mr. SAMUELSON. I stand twice rebuked. I have awarded an "ungentlemanly C" to the Joint Economic Committee. I call it an "ungentlemanly C" because a "gentlemanly C" goes to someone who did not try. I have no fault with the committee on this count.

Chairman PROXMIRE. Thank you Professor Samuelson.

Mr. SAMUELSON. What about the February and March view of the Joint Economic Committee? How have they stood up under the test of time?

Although it hurts me less than it hurts you, I must testify under oath that this has not been a vintage year for the Joint Economic Committee. The academic world has had a great deal of fun in quoting your report; and many an examination question during the spring was worded: "In half an hour, explode the fallacies contained in the following blank-blank analyses of the JEC."

I might say that the dishonors are about equally shared between the majority report and the minority report in this regard.

However, let me accentuate the positive.

On the major policy question—and I think it was the major policy question, whether to encourage the administration to pressure Congress for a 6-percent tax surcharge to go into effect on July 1—the committee stood like a rock. They were on the side of the angels—and the public welfare—in counseling: "No; wait and see."

And the angels were on the side of the committee. I mean the angels who take care of little children and the innocents, since the quality of the reasonings given for this correct recommendation were often *not* high. You will see that my secretary wrote in in small letters a very crucial "not."

Chairman PROXMIRE. I am glad you didn't write it in.

Mr. SAMUELSON. Example: A respected member of your committee, whom it would be libelous for me to name—although I understand that the courts now make it almost impossible to libel a public figure—argued that the economy was too weak to stand a tax rise and hence Government expenditure should be cut. He was joined in this "reasoning" by a vast majority of both the minority and majority of your committee.

Another example: Had the Federal Reserve acted upon the recommendation—and note this—of both minority and majority members of your committee, and made the growth in the money supply fall within the range of 3 to 5 percent per year annual rate—or 2 to 4 percent, according to the minority report—without regard to increases in Vietnam and other fiscal stimulus, in all probability the inventory overhang and capital-saturation incident upon the economy's leveling off would have culminated in that recession which we have avoided.

I may add, it may also have accomplished the task of saving face of those who argued that there had to be a recession based upon the behavior of the money supply in the last year.

This is a matter of opinion, not demonstrable fact; but since it is my opinion, let me make clear what it says:

In the short run, when prudent men have reason to fear that a recession is brewing, as testimony before you in February indicated, I believe, to be the case, it is not a crime for the money supply to be permitted or made to grow in excess of the long-term 3 to 5 percent average rate with which your committee has so recently become enamored.

In my judgment, your committee was sold a bill of goods by those witnesses who favored the extremist view that good macroeconomic policy consists of keeping the money supply growing at the same rate in every run of time, short-term and long-term. While I caution you against being taken in by such "snake oil," you must not conclude that I favor wild swings in the money supply or believe that such destabilizing swings will be the inevitable consequence of abandoning the constant-growth-of-M nostrum.

Unless forced to do so by a stern quiz giver, it is distasteful to dwell upon the inadequacies of your nonvintage March report. So let me conclude my backward look with one bouquet and one brickbat.

The Joint Economic Committee, both majority and minority, is to be commended for having recognized that the softness in the economy justified a recommendation to reinstate the investment tax credit. And the administration is to be commended for having acted so promptly to make a recommendation for restoration of the investment tax credit. I don't think I can congratulate Congress upon *its* promptness in actually acting upon that recommendation, but fortunately everybody pretty much knew that it would come to pass, that the investment tax credit would be restored, and so the damage that might otherwise have been done from the delay did not happen.

The majority report contains—in boldface—the view:

> The committee vigorously rejects the notion that a tax increase should serve as a "trade-off" for easing money.

As it stands, this could have a mischievous meaning. What the committee undoubtedly meant—that is, what I trust the committee really meant—was this:

> If, as we believe, the economy is too sluggish to require a tax increase at this time; and if, as we believe, money and credit should be made easier in order to forestall a recession and to promote full employment—then the Federal Reserve should not refuse to give us monetary ease merely on the ground that the tax surcharge is not being voted.

That is one thing. But the correctness of such a statement is quite consistent with the following:

> There most definitely, according to sound economic principle, has to be a "trade-off" between expansionary fiscal policy and expansionary monetary policy. For example, when the economy is showing healthy real growth of four percent per year, the mix of full-employment output between a healthy level of residential construction as against current consumption and some other components of capital spending will be much affected by the mix of fiscal and monetary policy. A rise in tax rates will most certainly permit an easing of credit to the real estate and housing markets. It will also lessen the probability of there occurring in the next period of inflationary pressure a money market "crunch" like that of 1966's late summer period—a crunch which so greatly worried the Congress.

Even the purveyors of nonvintage snake oil that I have been discounting realize that tighter fiscal policy will prevent the raising of interest rates and the unavailability of mortgage credit that bears down so heavily on housing and construction.

In fact, according to their model which I consider to be extreme and deficient, lower interest rates are the only effect that will follow from tighter fiscal policy.

The last point that I mentioned is very relevant for the future and I turn now to counsel for the future.

I judge that the balance of probability favors the view that the resumption of rapid advance will occur in the second half of the year. Since unemployment has stayed lower than any witnesses had forecast for so sluggish an economy, the administration is right to stress the danger that inflationary pressures may again be with us by the last quarter of the year or the first quarter of 1968.

Hence, the case is much stronger now for a 6-percent tax surcharge, or a tax surcharge of some other percentage, to go into effect around the turn of the year, say October 1, or January 1, than was the case last January for a July surcharge or than has been the case for a July date up to this moment.

Your committee was correct in February to listen to the counsels of Professors Tobin, Hansen, and Burns, and perhaps others, who told you to wait on the tax matter.

For how long is the counsel, "Don't fire until you see the whites of their eyes" tenable? Has the time come to form a firm judgment in this matter? Here is my considered opinion.

Although a strong revival is likely, it is still not here and it still cannot be counted on with complete confidence. Even such a matter as an auto strike could change the optimal timetable for a tax change. In Germany and many other parts of the world, what looked like upturns have recently turned out to be disappointing. That could happen here. The Troika experts in government—and I have in mind the various administration economists; and I shall extend that to the Department of Commerce and the Federal Reserve—have a better batting average in short-term forecasting than anyone else. I may add, that is not saying so very much; but it is still a calculated faith on their part that the economy will soon be overstrong.

The mere size of the deficit is not by itself a good reason for raising taxes. We should raise taxes primarily if we wish to hold down private spending on consumer and producer goods, and secondarily to change the mix in favor of construction. The Federal Reserve can easily permit the financing of even a large deficit at interest rates lower than the market now fears if the economy is not overexuberant in the next year. I must warn you against upside-down economics. Indeed, the weaker the economy, the greater the budget, and those people who rely on the wrong reason for raising taxes merely to finance a deficit would then consider the case for a tax increase improved. I and 99 percent of economic experts would argue exactly the opposite. Any large deficit created by weakness of the economy is, other things being equal, an argument against a tax increase rather than an argument for a tax increase. I will add, the greater the budget deficit as a result of weakness, the greater the reason for the Fed to increase reserves and hold down the growth of interest rates.

However, in view of the increase in Vietnam spending and the effects to be expected 6 months from now from the commendable money policy that the Fed has been pursuing this year, there is warrant for serious concern now. I may say that precisely because of this lagged effect of monetary policy, the optimum thing for the Fed to do 6 months from now may be to have the money supply growing at a slower rate than either the minority or majority report recommended; and you will again have the same parade of witnesses come up before you, chastising the Federal Reserve because it is not hewing to the chalk line which they regard as the only wisdom in these matters and which represents, I must report, an extremist view among the academic community.

My conclusion then is this:

Still hold your fire on the tax increase. We still cannot see, so to speak, the whites of the eyes of the inflation enemy. But the time has come to cock our guns. Instead of being "neutral" on the tax rise, we should be shifting to "neutral-for" (as against "neutral-neutral").

Then, if the fall brings concrete signs of a rapid upturn—a cloud as big as a man's hand will appear on the horizon and it will grow—Congress should then swiftly pass an increase in taxes of a magnitude suitable to the size of the indicated inflationary pressure. And the Joint Economic Committee should return to the mainstream of economic sobriety and lead Congress in formulating such a program.

Chairman PROXMIRE. Thank you, Professor Samuelson, for a most delightful statement, even if you will permit me to disagree slightly on your grading.

Chairman PROXMIRE. Professor Weston?

STATEMENT OF PROF. J. FRED WESTON, CHAIRMAN, DEPARTMENT OF BUSINESS ECONOMICS AND FINANCE, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. WESTON. Although neither of us saw each other's papers any earlier than you saw either of our papers, in a very real sense they complement each other in the aspects of policy with which they deal. A review of the evidence on the economic outlook still presents mixed indicators. Partially this is due to the new significance of some of the elements in our economic time series.

For example, to illustrate with regard to the inventory statistics, I believe that an analysis of the composition and environment in which the inventory buildup took place changes very greatly the meaning of the large inventory buildup.

For example, one very significant component represented in-process inventories which were very heavily related to the defense buildup and in turn related to the institutional factor that defense procurement involves increasingly long leadtimes, so that progress payments are made.

While these progress payments are being made these are still counted as increases in private inventories and, instead of working these inventories down by cutting production, the defense inventories get worked down when the projects are completed and deliveries are made and this then enters into a final gross national product.

So you have a very significant element of the inventory buildup that has a greatly different significance from the traditional characteristic. Another aspect is the significance of inventory buildup in a period of rising costs. Again, there is the tendency to work such inventories off not by cutting back production which will then at a later stage replace those inventories at higher costs but rather to maintain production and have the inventories worked off as final demand grows at less than an accelerating rate.

I think these two aspects of the inventory data are part of the reason why there has been a relative employment stability, virtually no increase in the unemployment rate, while the FRB index of industrial production has been declining somewhat.

I think the other partial explanation for the relative employment stability is the increased training content of workers and hence the reluctance to separate workers from the work force and then go through the task of retraining. It is these kinds of characteristics of the data that make an analysis of current economic series, including leading economic indicators, not completely persuasive in one direction or the other.

The other paradox is that the FRB index, as I indicated, has been down but long-term interest rates are already at higher levels than experienced during the severe credit crunch of August 1966. Yet the Fed in recent months has been pursuing a comparatively easy money policy. The explanation is that, in fear of a credit crunch in the fall, corporations are going to the long-term bond markets in very huge droves—and, incidentally, not calling on the commercial banking system. The rate of expansion in commercial bank loans is down so that that, as an indicator, is taken as softness. The tremendous calls on the capital markets, the long-term bond markets, are indicators of strength. When interpreted in any meaningful context it has quite a different significance than what you would get from a mechanistic interpretation.

In view of the increased difficulty of interpreting the economic statistics, I would argue for bringing into view again proposals that were made several years ago that have been relatively neglected in recent discussions and I should like to restate the consideration for a shift in some aspects of taxing authority.

The policy prescription here recommended rests upon a fundamental distinction in responsibility for tax policy. When the structure of our tax system is to be changed, this is clearly a prerogative of the Congress. As is proper, the procedures necessarily call for prolonged hearings before the House Ways and Means Committee and then similar hearings before the Senate Finance Committee. This is a process which, by its very nature, involves several months of discussions, deliberations, and analysis. When we consider a change in the tax structure, we are essentially concerned with the equity, redistribution, and differential incentive effects of our tax system.

But, of course, our tax system also has an important role to perform in contributing to economic growth and stability. In performing this role the essence is speed and prompt anticipation of or reaction to economic developments. The nature of the relationships between the behavior of economic statistics and economic principles and economic forces suggests that the reaction time in Federal Government policy be shortened. One important way to achieve this would be through granting to the Executive Office of the President the power to impose a positive or negative surcharge within some range, perhaps up to plus 10 percent or minus 10 percent of tax levels at any particular time.

The arguments for this grant of power in my judgment are overwhelming. They are:

One, it would speed reaction time for altering economic policy by the executive office.

Two, it would give a portion of the requisite authority required by the Executive Office for coming close to matching the overwhelming responsibility which it has for economic performance.

The argument against such a grant of authority is that it transfers some of the basic prerogatives of the Congress to the executive branch of our Government. But as my previous analysis has indicated, this position has no substance if the distinction is recognized between responsibility for changing the tax structure and responsibility for changing the overall average of tax rates.

But for those who find it difficult to contemplate such a formal transfer of authority, it may be appropriate to initiate steps toward such a policy by making the grant of authority limited for 2 years or some specified number of years. This limited grant could also be composed to provide that at the end of the 2 years any changes that had not been reversed at the expiration of that period, would at that time be eliminated and the level of taxes would return to the state that existed at the time of the grant. Or alternatively, Congress might be willing to grant to the President limited authority to raise taxes, but retaining unto itself the power to reduce taxes.

Surely the risks of following such a policy for a limited period of time are minimal. This policy change is recommended and supported by the entire sweep of economic and political developments that have taken place in the United States since the end of World War II and in turn reinforced both by the mixed behavior of the economic time series during any period of adjusting one rate of growth to another and the kind of qualitative analysis and understanding that is required for a real meaningful interpretation of the statistics as illustrated by my discussion of the inventory statistics and the unemployment statistics at the beginning of this presentation.

The Two Wars

Another one of the basic policy alternatives that has been formulated is the choice between increased defense expenditures to meet our worldwide responsibilities versus increased expenditures on what has been summarized in general terms as the "war on poverty." Some have taken the position that our expenditures in relation to our worldwide commitments represent inexorable pressures. This view holds that we have very little discretion in the international area and therefore it is urged that we cannot fight two wars at once and this point of view concludes that since we are impelled to fight the war against various forms of aggression abroad, we must postpone the war on poverty at home.

I would argue that the web of past events provides very narrow constraints. The Congress in its previous decisions has preempted discretion and policy choices with regard to the present policy alternatives that are open to them.

Among the most important of these previous decisions stands out the successive increases in minimum wages. As minimum wages are imposed and successively increased, in a private enterprise system a number of workers whose education, training, experience, and therefore productivity did not command a level of wages now established by a minimum wage are "priced out of the market." Certainly for a period until perhaps capital investment adjustments may be made to increase their productivity but in the meantime a necessary concomitant of legislation which establishes minimum wages is a program of legislation to provide education and training for those who otherwise would be unable to obtain employment. And in the interim while the requisite education and training is being achieved, direct forms of Government aid and relief are required to avoid undesirable and unacceptable hardship.

Two circumstances taken together establish some strong imperatives. On the one hand, to impose and successively raise the level of minimum wages requires that worker productivity be improved but an important reinforcing factor has been developing and that is that in a world with increased mobility, increased communication, inequality of social and economic position is less tolerable. In a world in which increased communication and mobility portrays such inequality, strong stimuli to aspiration levels are engendered or produced.

So two things have taken place at once. At the one level increased aspirations of disadvantaged groups is a result of these changes in our society that I have described. On the other hand, Congress, by its own previous actions has created a situation in which the productivity of the disadvantaged people must be improved if sociological pressures of seriously disturbing consequences are to be avoided.

The implications are clear. The policy requirements are again inexorable. In an economy operating near full employment because of increases in Government outlays related to the fight against external aggressions, there is little flexibility for increased Government spending on the war against domestic disadvantaged groups without appropriate increases in taxes. And, of course, explicit in this is that we will see the reflection of this in a strong second half for 1967 and inevitably with an economy operating at relatively full employment, additional income injected into the economic stream by the war on poverty must be taken out of the system through taxation. Obviously a tax structure with progressivity results in some redistribution of after-tax income.

In a world environment and with requirements of our own economy as pressing as they are, no one can seriously claim that such income redistribution in the present atmosphere and environment will have adverse incentive effects in the short run. And I argue that they would not have adverse incentive effects in the long run given the power of increased output through the powerful productivity of our economy.

The tax policy implications, therefore, are clear. As discussed above, we may acknowledge that the economy is poised at a somewhat delicate balance in current weeks and again it understands the need for increased flexibility in taxing power at the level of overall taxes as described in the first part of this statement.

Government Price Controls

Another major policy principle, it seems to me, should be recognized by the Congress. One of the strengths of our free enterprise system is

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the use of prices to allocate economic resources. Yet the Congress persists in flying in the face of these fundamental principles by imposing various kinds of price controls, particularly in the area of the operation of our capital markets. In view of the dramatic developments in our capital markets in recent weeks I wish to present two illustrations of the generalizations that I have been expressing:

The first is the limitation on the level of interest coupons that may be paid by the Treasury on Government bonds with maturities in excess of 5 years. The recent extension of permissible maturities on notes to 7 years is only a token recognition of market realities. Of course, this limitation is only on the issue of new bonds and has no effect on yields of secondhand bonds. Therefore, I can think of no valid or sensible economic basis for imposing price controls on Government securities. All that such restraints accomplish is to limit the flexibility of the Treasury, produce distortions in the money and capital markets, and end by costing the taxpayer more to finance our debt. Of course, it is such rigid ties that distort the effective functioning of our money and capital markets.

Another area that for decades has represented a shameful practice that has impaired the credibility of congressional competence in economic matters has been the curious legislation known as the debt ceiling. The presumed advantage of the debt ceiling is to impose a brake on rising levels of Federal Government expenditures.

But it is the Congress which has and does exercise the power of making appropriations. This provides the fundamental determinant of the levels of spending. It is Congress also which has determined the level and structure of taxation and therefore of revenues for a given level of economic activity. The net result of decisions on expenditures and revenues by the Congress determines whether there will be a deficit or surplus in the budget. And it is the accumulated deficit or surplus that determines the level of the Federal debt.

Thus having established the revenue levels and the spending levels, Congress has already determined what debt levels will be. Therefore, to have another set of policies determining what debt levels shall be is to involve from time to time administration in difficulties and embarrassments and makes the Congress itself guilty of inconsistency. But more importantly again from the practical standpoint of the operation of our money and capital markets the practical impact, you have two impacts of the debt ceiling. One is obviously that it is a convenient political device for causing embarrassments to any administration and, second, from an economic standpoint it introduces increased uncertainties in the market for U.S. Government securities, as well as by restricting Treasury financing flexibility and therefore the debt ceiling limits themselves undoubtedly—I said "may" in my written statement, but I will say undoubtedly contribute to higher interest costs on U.S. Government securities and therefore these debt ceiling rituals are likely to have consequences the opposite of those intended.

There is another strange misunderstanding in connection with public and private debt that needs some clarification. Attempts to limit the growth of Federal debt by the debt ceiling provisions reflect a presumption that Government debt has a questionable economic function to perform. But again since it is Congress that determines appropriations and therefore the patterns of expenditures of Federal spending, such a criticism is a criticism of the congressional process of allocating Federal funds for spending. But the data I think are also significant. Analysis of the patterns of debt increases in the postwar period reveals marked differences in the rates of growth between public and private debt. Federal debt has increased from $266 billion in 1950 to $328 billion at the end of April 1967, an increase of $62 billion. This is the smallest absolute increase in any of the major debt series.

State and local government debt increased from $20 billion in 1950 to $100 billion in 1966, an increase of $80 billion. Corporate debt increased from roughly $140 billion in 1950 to over $500 billion in 1966, an increase of $360 billion. Individual and noncorporate debt increased from $110 billion in 1950 to almost $500 billion in 1966, an increase approaching $400 billion. The latter as a percentage of disposable personal income rose from about 50 percent to almost 100 percent between 1950 and 1966.

Thus the increases in private debt have far exceeded the increases in public debt since 1950. This is not to decry the growth in private debt. I think a strong economic case can be made that the growth of both public and private debt has performed a constructive role in the postwar period. Basically the growth of debt is a form of financial intermediation in which the funds of the saving segments of our population can be productively utilized. The point I wish to emphasize is the irrational and unfounded objections to the growth of debt for the Federal Government (as well as for the State and local governments), as distinguished from private debt. If our more pressing needs are public ones, it makes as much sense to finance such long-term outlays with debt as for IBM to finance new computer systems with debt. And this underscores a point that Professor Samuelson made that really the only valid economic criterion we have to judge whether a prospective $10 or $20 or $30 or $40 billion increase in the Federal debt in any fiscal year is too high or too low is in relation to the job that it needs to perform with respect to the requirements for economic growth and stability during the period under consideration.

Conclusions

To conclude, the web of international events and pressures has cast its nets. In the evolution of developments that has occurred, we have moved by reluctant stages to a situation that really no one is happy with but from which it is difficult to extricate ourselves. In such a set of circumstances it is easy to criticize because there is much that is unsatisfactory even to those who are assigned responsibility for being the supposed architects of the policies and situation.

To summarize, then, three areas deserve our attention in relation to improving the situation.

First, is the need for greater flexibility in tax policy to keep the mix of monetary fiscal policy in proper balance.

Second, is the necessity of following through on commitments imposed by previous congressional actions and therefore the recognition of taking sociological considerations into our analysis as well as economic.

Third, is the requirement for instituting economic rationality for a number of political rituals that have interfered with sound economic performance by Congress.

These, in my judgment, are the high priority requirements at our present juncture of political and economic developments.

Thank you.

Chairman PROXMIRE. Thank you very much, Professor Weston.

Professor Samuelson, in your very delightful and stimulating presentation, you suggest in your conclusion that you are now neutral for a tax increase with your finger on the trigger but not pressing, and you would concur, I take it, in the view that if the administration may feel that they have to make a decision in late August in order to permit time for Congress to act, they should not make that decision now; they should make it in late August, because it is conceivable possibly that economic developments may change significantly in the meanwhile and make a tax increase inadvisable. You would make the suggestion that the decision should be made at the last possible minute, based on all the statistics at that time; is that correct?

Mr. SAMUELSON. Yes, subject to one reservation. I am not an expert on the lag that is involved in persuading Congress to do the right thing, what the time interval must be between making a specific recommendation and the gestation period within the brains of the Congressmen; so, provided expert political judgment determines that August is not too late a date for action before the end of the year, then I would agree to delay.

Chairman PROXMIRE. As you know, this depends, of course, on when Congress makes up its mind to go home. We act more rapidly when there is pressure to adjourn. Obviously, if we got a request to enact a tax increase in January when we were going to be in session all year, we would have a much more leisurely approach than if it were toward the end and we had to say yes or no before we went home. I have been very much impressed by two developments that we have had just in the last couple of days: first, by the presentations by Mr. Katona and Mr. Paradiso yesterday. You may have had a chance to read their statements. Mr. Katona indicated that the consumer expectations and consumer behavior are unlikely to be exuberant, that it may very well continue as it has been over the past 4 or 5 months with a greater propensity to save than had been anticipated.

Mr. Paradiso indicated that there were still serious inventory adjustment problems that would tend in his judgment perhaps to slow down production somewhat, or at least not make it expand the way that had been anticipated. Second, in the morning papers the Bureau of Labor Statistics' interesting report on consumer prices appeared. It is true that they indicated that prices went up three-tenths of a percent in May, but for the first time that it has been called to my attention they also had an interesting analysis of the difference between price behavior this year and last year. They say they can account for it very largely through what has happened to food prices. Food prices dropped this year and rose sharply last year, and without food prices you would have gotten about the same price behavior.

That suggests to me that we didn't have any really big demand pressure on prices in 1966, because food prices are pretty insensitive to demand at least to fiscal policy actions. And with this in mind I would say that we can perhaps stand the kind of growth of 5½ percent real growth that we had in 1966, or close to it, at least more than 4 percent without very great inflationary pressures.

There may be other developments on interest rates and other things, but as far as prices are concerned, I wonder if we can isolate that factor.

Mr. SAMUELSON. Let me comment on the two different points that you have made. I thought, and a number of economic analysts thought, that the Council of Economic Advisers, in its annual report, was being optimistic that the consumer saving ratio would fall, and that consumption would be strong this year. On this point, I was an agnostic, and if the survey of consumer prices suggests that the savings ratio will be high, I have no reason to disagree with that.

I would like to say that I have scrutinized those surveys for many years very carefully and have not found them as helpful to me in forming my opinion as I had hoped they would be. The consumer is a little bit like Mr. Dooley's Supreme Court. He seems to *follow* the business returns; and belatedly we seem to learn from Ann Arbor that the consumer has done what we are seeing him do.

Secondly, there has been a lot of loose talk about the inventory overhang being behind us on the basis of favorable 1 month's statistics, February.

Chairman PROXMIRE. February or May?

Mr. SAMUELSON. No; as early as February those who grasp at the straws of optimism were saying that the worst is behind us. I thought that that was premature. I would suppose that Mr. Paradiso's estimates for the rest of the year, which are for very modest strength in inventory growth, have to be given very serious weight.

Still I would say they are a little on the low side compared to the modal estimate by experts; and Professor Weston has given some reasons why inventory might be different. But I wouldn't expect the strength in the economy to come there. On the other hand, when you look at all of the components of the GNP, which is what one has to do, the best guesses that I have seen suggest that in this current quarter that GNP will increase by $10 billion, although it increased by only $4½ billion in the first quarter. Final demand has been holding up well, that is GNP purged of inventory behavior. So if somebody tells me there is considerable likelihood for a $12 billion increase in the third quarter and at least $15 billion in the fourth quarter, I don't think one can lightly discount that.

You have derived some comfort from a three-tenths of a percent increase in the consumers price index, based upon the qualitative composition of that increase. Just looking at the figure itself, I do not derive comfort.

Chairman PROXMIRE. Could I interrupt to say that I am not sure that I indicated I derived comfort from that three-tenths of a percent increase in rate? What I did derive comfort from was the analysis that said that over the period of last year and this year, if you take the food component out, that there isn't much difference in the price performance, although this year we have had a relatively stagnant economy with obviously lesser demand pressures than last year and the performance didn't differ. And, as I say, the food component is not very sensitive to fiscal policy.

Mr. SAMUELSON. I am glad to have that clarified. I didn't mean to imply that you inferred anything from the total. I would like to register agreement that food prices is an erratic noise in the signal of the price index. Food follows its own drumbeat. It goes up and down.

And very often food prices are something very important to the housewife, so that people may form their expectations of what is to be expected of inflation generally from exaggerating the latest twist in food prices.

Still, I think that the problem I should warn about is this: If the fashionable view is correct that there is a pickup in the economy so that the GNP is growing at rates of plus $15 billion per quarter instead of the $4½ billion and the $10 billion rates just behind us, then I cannot escape the conclusion that there is a serious danger of an increase in price pressure in the nonfood items of the index. So, only if I learn from the passage of events that the rather more pessimistic estimates made by some forecasters do materialize, would I be complacent or at least nonapprehensive on the price front.

Chairman PROXMIRE. Let's see if I can get at the situation that you might envision in August of this year or later in this year, maybe even September, which might persuade us not to press for a tax increase.

No. 1, we have a situation in which, as was indicated a couple of days ago, there is a lot of resilience in the economy. We didn't have any increase at all in the employable people in the work force in the first quarter of this year. In fact, we have had a decline in the first 5 months, when we should have a normal increase of a million and a half over the year in the work force. Obviously, these are people who can come back in if necessary. We had a sharp decline in the number of hours worked down to 40.3, which is the lowest in 6 years. We have a plant utilization of 87 percent. We have had a terrific increase in capacity over the last 3 years, perhaps more than at any time in American history. So that we are prepared in terms of facilities and personnel to move ahead rather rapidly.

I think there is concealed in this 3.9 percent unemployment an opportunity to move ahead, not only in the elements I have mentioned, but also in terms of the fact that there was no productivity increase, because there had been a slowdown. As we move ahead and expand, we are going to be able to call on a lot of those resources before we get to the point where there are facility shortages and massive, significant, big manpower shortages that would put pressure on prices. This is especially impressive to me because of the apparent fact that there wasn't demand pressure in 1966, if I am not overstressing what the Bureau of Labor Statistics is telling us this morning.

Mr. SAMUELSON. I would like to register very strong agreement that we should not be overly complacent about the unemployment statistic having remained so low. Nobody had predicted that, and it seems to have come about for reasons that are still not clear. But, primarily, in my judgment, you have had a shrinkage of the marginal, labor force. I think there is a social evil, other things being equal involved in that. Youth and many groups who feel unemployment the worst are feeling this pinch.

In a sense, in a very affluent mixed economy like ours, we can sweep under the rug for a short period of time evidence of growing slack, but that doesn't mean that it isn't there and isn't costing us something. And I agree with you, it is a resource upon which we can draw. Furthermore, I think there is a hoarding of labor by corporations in a tight labor market as output goes down. We have seen this again and again in Europe. They would never dream of letting a good man go, because they might not get him back in a tight labor market. A lull shows up as a drop in productivity; but the other side of the coin is that productivity can again improve if effective demand is there.

I don't want to be pessimistic about the behavior of prices based upon the present rate of advance, or even some slight improvement. On the other hand, I wouldn't counsel an increase in tax rates if all that was in store for us, according to our best guess, was a resumption of $10 or $12 billion of GNP per quarter. It is the fact that this may snowball into something bigger as you come up the incline. Historically, after pauses and recessions, the first few quarters can be very exuberant indeed; and this time we do not start from a low level of employment but from a high level of unemployment; and we do not start from disastrously low levels of capacity operation, although they are lower than in 1966.

I may also say that there has been some favorable behavior, if you want to take the worm's eye view of every last statistic, in the productivity data and in the wage cost per unit of output. That was a series which behaved unbelievably well for 4 or 5 years in the 1961–64 recovery; and then, like all good things, it did come to an end in its good behavior and began to rise. In the last few months, as I understand it, it has been pretty nearly stationary, and that gives us some help.

I would like to reinforce, for your committee, the testimony which Professor Tobin gave in February, in which he stressed the great importance to all the Nation of high levels of economic activity, and that we should not be complacent in the interests of other goals in letting the level of unemployment and degree of excess capacity rise. If we learned anything in the 1960's, it is that success does succeed. And in the 1950's we did a bad job in this regard.

Chairman PROXMIRE. My time is up. I might say that, speaking for the committee, we did say that we would recommend a sharp cut in the spending, $4 to $6 billion, or something of that kind, or $5 billion, provided exuberance in the economy developed, as an alternative for a tax increase.

We didn't say the economy was too weak, as you implied in your paper, for a tax increase, and therefore we ought to cut spending. That, obviously, should have been graded a flat flunk, but I think that the other has some merit.

Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

I would like to compliment both witnesses on their fine statements and also the humor that has been shown by both of them, even though it is at our expense sometimes. I would like to know what your first recommendation would be for a low-calorie tonic for the Joint Economic Committee to take to acquire economic sobriety in the mainstream. What is the first action you would recommend for us to take?

Mr. WESTON. Well, in my statement I argued that you should be strongly supporting increased flexibility on the tax side. I would vote for support of a change in the administrative structure of the mix of powers to have increased flexibility and the possibility of a speedier reaction time to avoid some of the problems that have been indicated in the restoration of the investment credit.

We know that that was delayed for unrelated reasons: arguments over a rider that had no relationship to the economic issues reflected in the restoration of the investment tax credit. This would make even an allwise political theorist——

Representative WIDNALL. Are you recommending we abolish the Senate?

Mr. WESTON. No, quite the contrary. I think it has some important functions to perform. But it shouldn't have authority over those areas for which the Executive Office really has responsibility, and that was the reason for my emphasis on the distinction between tax structure, the responsibility of the Congress, and the level of taxes within some discretionary limits, a responsibility of the Executive Office or at least outside Congress, just as monetary policy is outside Congress. Since the two strong areas of force of policy—monetary and fiscal policy, should be conducted with some proper balance between the two, it would be an improvement for tax policy not to be such a potentially sluggish element in the system.

It seems to me that, in view of the events of the last year where outstanding experts can't agree even that the tendency is toward a plus or minus side, and where increasingly with the complexity, increased complexity of the interrelationships between the economy which makes the interpretation of statistics more demanding, that speeding the reaction time on taxing policy is something that has a considerable amount to recommend it. I am surprised, in view of, as I say, the numerous people who were recommending this several years ago, that this has not even been mentioned in an economic setting where it seems to me that the facts themselves represent a very strong argument for it.

Mr. SAMUELSON. If I may be responsive to your question very briefly, from a technician's viewpoint, two things stand out in the last report; two aberrations, as I recall it. One is the adoption of a very strong and new view for this committee with respect to money. Now, money is very important, but it is not important in the way, in my judgment, that your majority and minority reports have believed in plumping for a fixed rate of growth of money. I can enlarge upon that.

The second aberration that I detect in the report is, in my judgment, a false asymmetry between the attitude toward tax change as one weapon of fiscal policy and toward government expenditure change as a weapon of fiscal policy; and I do not see in your recent report an even-handed treatment of these issues and understanding of them from the standpoint of stabilization.

Specifically what I have in mind is this: a person may be of the judgment that we have too much government spending in this country. He may have that judgment in season and out of season and then, quite without regard to stabilization, he may press for a reduction of what he considers to be inefficient, wasteful, or low priority spending. Or a person may have a judgment that we have too little public expenditure and that we are surrounded by private opulence and public squalor; and in season and out of season he may preach the message that we need more public spending.

I can understand that, and that has no regard to stabilization. But whenever the issue of stabilization comes up, I detect increasingly (and I think a student of content analysis who analyzes documents point by point and counts the frequencies on the computer with which they occur) that again and again the *Carthago delenda* *est* refrain of this committee is "Government expenditure should be cut." If the economy is weak, that is a reason for cutting it. And if the economy is strong, that is a reason for cutting it. And if the economy is in between, that is the best reason for cutting it.

Representative WIDNALL. Do reductions in expenditures have the same economic impact as increase in taxes?

Mr. SAMUELSON. I would say that a reduction in expenditure of a billion dollars is more anti-inflationary, is slightly more depressing than the same increase in tax revenues of a billion dollars. And, by the same token, an increase in Government spending of a billion dollars is slightly more expansionary to real income production and employment and to excessive buoyancy, if there is excessive buoyancy, than a billion dollars of tax reduction. But to a first approximation you might treat them as the same, and I have just given you the second approximation.

Representative WIDNALL. Professor Weston, do you have any differentials?

Mr. WESTON. No.

Representative WIDNALL. If the administration budget deficit for fiscal 1968 was $20 billion, approximately how much new financing would be required by the Treasury, in your estimation?

Mr. SAMUELSON. I should like to disqualify myself from giving an expert answer to that question. I haven't studied the exact relationship of the administrative deficit to the money market, because the administrative deficit is so meaningless a concept that I have to consult the latest opinions and resolution of Congress to see what its economic impact is. For example, if Congress passed a resolution that there be no participation certificate selling, that changes the administrative deficit, even though it may not change the total amount of securities going to the capital markets.

If Congress does or does not act upon the social security benefits, that will have no effect upon the administrative deficit to first approximation, but has a substantial effect upon the economy. So I consider the administrative budget not as a numbers game, but as kind of a word game in the internecine warfare between Congress and the Executive. Generally I have better uses for my time than to waste it on keeping up with the nuances of the worsening administrative deficit.

Representative WIDNALL. Of course, we are concerned with what is going to happen to interest rates and how much Government borrowing is going to take place, and how much that Government borrowing is going to interfere with the normal flow of money into other areas of the economy. And many of us, I feel, have been concerned that, through the sale of participation certificates, the rise in interest rates was stimulated and also mortgage money lessened; and we seem to be headed in the same direction right now and I don't see anything in sight that is going to drive interest rates down now. Do you?

Mr. SAMUELSON. No. I think there are many signs to suggest that, if the general forecasts that the most experienced people have been giving are right, then we may build up to a similar credit "crunch" as in mid-1966. I hope we will be a little more sophisticated both in the public and in Congress in dealing with such a crisis if it occurs. I should add that the 1966 tightness was not primarily due to participation certificate sales that Congress forced on the Executive.

But I should like to be responsive to your particular question, if I understand its implication. How much the Government collects in taxes by change in tax rates does have a direct influence on how much public debt has to be floated in the market, and on exactly what the competition for funds will be as between other uses of funds. So taxation is not a neutral matter. Tax rate increases have consequences, both upon (1) the *current flow* of income, and (2) upon the composition and balance-sheet stocks of securities and their yields.

Mr. WESTON. I think one should recognize in this connection that the fears of a crunch in the fall similar to the crunch that occurred in 1966 in the fall have already produced a crunch in the late spring and early summer in the long-term capital markets. This has already taken place on an anticipatory basis, so that in this sense the capital markets are fighting the last war in terms of fighting the crunch that occurred last fall, the fall of 1966, by trying to anticipate it early and certainly by seeking to free themselves of dependence on bank credit in order to have availability of funds, even going out and paying very high rates at the present time.

What actually will transpire in the fall, I think, is a combination of a number of influences. I think the fact that such a crunch has already taken place is a favorable factor. As is so often the case, you get an overshoot, and we probably are experiencing an overshoot in terms of raising long-term bond money which will be a positive influence in terms of pressures on the market to avoid competition with the Federal Government when it does come into the market. But again, the level of the economy itself in the second half will be higher, which will have an impact on the productivity of the revenue system, the level of the revenues coming in regardless of the timing of the tax increase. But then again the timing and the amount of the tax increase is another variable, and of course the various forecasts of the rate at which spending may increase in the defense and nondefense areas, and finally the whole tone of monetary policy.

Now, the monetary authorities have indicated that the demands on the long-term capital market have been such in the last several weeks that No. 1, they were unanticipated by the Fed; and, No. 2, they were so massive that the Fed was powerless to prevent long-term rates from rising. I think one can be sympathetic about the first point, that to some degree these were unanticipated; but I don't think that one can agree that the Fed was powerless to forestall the increase in long-term rates.

There exists some level of open-market operations by the Fed that would have forestalled it even with some lag, and this is a matter of determination rather than power on the part of the Fed. It probably reflects the view that the economy is moving into a very strong period which has stayed the Fed's hand in taking actions to prevent the long-term rates from rising in the present circumstances. I think that the rise in the long-term rates is not so much a measure of the Fed's lack of power, but rather a measure of the Fed's judgment of the economic situation.

Representative WIDNALL. May I just ask you both the same question? Do you believe that a tax increase, if effected this year, should be across the board and shared equally by corporations and individuals?

Mr. SAMUELSON. I should think that a similar percentage applied to corporate income and personal income, in the form of a surcharge of 6 percent or 8 percent or 10 percent or 4 percent, as the dosage may require, will: one, commend itself to people as being perhaps politically noncontroversial, and therefore could expedite quick action when you need it; and, two, is not a bad mix from the standpoint of economic policy.

At an earlier date one might have said that there was a case to be made for increasing the percentage on the corporate level compared to the personal level, particularly with the restoration of the investment tax credit as replenishing the position of the corporations. However, by almost any calculation in the near future, at least, I think there is going to be pressure on profits. Profits dropped 6 percent in the first quarter. I would think that they may be off by more than that in the second quarter. A round number for the year which I saw estimated by an economist for one of the large chemical companies was a 9-percent drop in profits before taxes.

Since profits are volatile, since they are coming down and there is an erosion, I think that not hitting them particularly hard might be economically defensible, and so kind of the neutral-neutral consensus package would be on both equally.

Representative WIDNALL. My time is expired, but I would like to hear Professor Weston's reaction to that question, too.

Mr. WESTON. If you argue pure economic logic, when the investment boom was strong, the argument to impose differentially on corporations as compared with individuals was a valid one. Now, by the same reasoning with prospective pressure on corporate profit margins with some tendency toward excess capacity and therefore no vigorous investment boom certainly as was the experience in 1966, the same economic logic would argue, a little more strongly I think than Professor Samuelson's analysis just concluded would indicate, that there would be some differential treatment for corporations. And in this sense fiscal policy, like monetary policy, even when you change the overall average levels, isn't neutral in the light of differences in economic circumstances that may be prevailing at any point in time. But where the major emphasis is on overall economic stability and where when you get into a determination of the magnitude of the differential treatment of individuals and corporations, and then when you pile on top of this the political overtones, I think from a practical standpoint, if your main motivation is stability, then the most convenient thing is across-the-board treating individuals and corporations alike.

Representative WIDNALL. Thank you.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Professor Samuelson, when you have given out marks to your students, do they ever come around afterwards and try to get you to raise them?

Mr. SAMUELSON. Yes.

Representative REUSS. That encourages me.

Mr. SAMUELSON. My practice, by the way, is to permit that, but with a penalty. That is, I or a more objective colleague take a fresh look and the score can be marked up or down, and they know that.

Chairman PROXMIRE. You may end up giving us a D.

Representative REUSS. With that hazard in mind, I call your attention to the majority Joint Economic Committee report which said that the first imperative for fiscal policy in 1967 is that Congress must find ways to reduce expenditures for fiscal 1968 by at least $5 billion, from which Congressman Bolling and I dissented in our separate views, saying we cannot agree with the majority's central thesis that the economy is so weak and the possibility of a downturn so great that we cannot afford to raise taxes, but at the same time we should cut expenditures by about the same amount as the administration proposes to raise taxes.

Now in the light of what you have said, that a request for a raising from a C to a C-plus sometimes involves your reading the whole paper and making an independent judgment, I won't at this time ask you to reconsider Congressman Bolling's and my view.

Mr. SAMUELSON. On the contrary, I have never believed in guilt by association, even in a partisan sense, and I had noted in doing my homework your reservation and I had given extra credit to you two members for this. I had thought that careful textual examination of my document might show an explicit recognition that some of the committee had a reservation in that respect.

Representative REUSS. The overall mark of C was given to the committee, but I won't raise this question for the reason I have given. Let me instead ask this.

Mr. SAMUELSON. I may say, by the way, that performance like that only brings into sharper relief the misdemeanors of the other members of the class because it had been called to their attention.

Representative REUSS. I don't wish to become teacher's pet. On a more serious matter, the view which Congressman Bolling and I espoused in our separate view is one which I still hold, and while I can't speak for Mr. Bolling, I think he does too, and that is this: that given the situation we now find ourselves in with a very sharp budget deficit in prospect, a budget deficit ranging, you name it, from $10 billion to $25 billion, of which I don't think more than $2 billion or $3 billion can be attributable to weakness and loss of revenues, because I think most of that deficit is a straight, old-fashioned spending-more-than-you-take-in deficit. With that big deficit facing us, but with the overall demand situation at the moment not really making an inflationary bite, isn't the following what ought to be done? Shouldn't Congress do two things, the sooner the better: One, pass something like the administration's 6 percent surcharge request, providing that it not go into effect until such time, if at all, as Congress by joint resolution determines that demand inflation is indeed upon us; and, secondly, act right now to raise $3 billion worth of additional revenues by plugging certain politically pluggable tax loopholes?

I think here particularly of such loopholes as the present one which allows someone with an unrealized capital gain to escape the income tax on it if he holds the securities until death. This loophole alone would yield roughly $3 billion a year in additional revenues. It was sought to be plugged by the administration back in 1962, and for one brief glorious moment the House Ways and Means Committee, by majority, actually voted for plugging that loophole. But it later got lost in the shuffle. But my point is that plugging such a loophole would, to a minimum degree, chill consumer spending and productive investment.

A large part of the $3 million or so that would be brought into the Treasury, had it remained in the taxpayer's pockets, would not have been spent on either consumption or production, but building up the assets, assets in Wall Street, commodities, or would have gone into foreign investment. Therefore, my thesis is that it makes good sense to take some of the heat off monetary policy by plugging that kind of a loophole, and it would have a minimal demand chilling effect, which in the present conjuncture we are not sure we want to chill.

Mr. SAMUELSON. Each of us has his *Carthago delenda est;* and I might say I am on record as favoring plugging up that loophole, so that this or any year is the time to do it, but I would consider it to be a side issue when it comes to stabilization, and I wouldn't primarily recommend it on that account.

Representative REUSS. Why isn't this a better than ordinary year to do it, because this is the year when the avoidance of a greater deficit than is really necessary makes a lot of economic sense?

Mr. SAMUELSON. Well, there are a couple of answers to that, although I put them forward diffidently. For one thing, this would mean that some other year—a surplus year—is going to be worse than a normal year for doing it, even though I shall still want it done.

But actually, since closing this loophole has no effect, as you point out so cogently, upon the balance of current saving and investment, and supply and demand, it has no effect upon that part of the deficit which does worry me.

The Federal Reserve can provide the same money that could be provided in this way with the same lack of risk, in my judgment. But I would like to hasten on to the other part.

Representative REUSS. Don't hasten, because this point does bother me and it turns up in your paper where you say, and I am quoting, We should raise taxes primarily if we wish to hold down private spending on consumer and producer goods. * * * The Federal Reserve can easily permit the financing of even a large deficit at interest rates lower than the market now fears, if the economy is not overexuberant in the next year."

Now, it seems to me that if you can save $3 billion worth of Treasury borrowing by recouping the revenues by plugging the loopholes we are talking about, you thereby ease the burden on the money supply by that amount and you achieve lower interest rates, particularly at the long-term run, than would otherwise be the case.

Mr. SAMUELSON. I don't think so, and let me explain why I think not. Let's suppose that all of these people who have obligations, which under new law would be tax liabilities, actually held greenbacks, and we collected $3 billion of greenbacks from them because of this new provision. That would certainly make it unnecessary for the Federal Reserve to create $3 billion worth of greenbacks; but, since I don't consider these to be a heavy cost of creating new money when the Federal Reserve *ought* to be creating new money, I don't consider there to be any considerable saving to the economy from what you have described—except that fundamental reason which is in favor of closing the loophole; namely, if you believe, as a matter of equity and as a matter of proper taxation of true income, that this loophole should be plugged. But that is argument for its own sake.

Representative REUSS. But it also has the advantage of saving the taxpayers from here on out the interest charges on that unnecessary

$3 billion of debt that the Treasury would have to borrow if it doesn't get it by way of tax revenue.

Mr. SAMUELSON. That is true. Any money that you take in from people saves future interest. Thus, suppose you ask everybody to send in a tenth of all the government bonds he owns by law: that will also reduce in perpetuity the amount of interest payable on the outstanding debt, because you would have reduced it. It would be a capital levy. Nobody would recommend that, because there is no reason in equity under conditions like these to reduce the public debt in that way.

I am for your proposal, but I am for your proposal for the same reason that I would be for it next year and the year after when economic conditions are the opposite of what they are now. I cannot find great merit in this reason for the proposal.

Mr. WESTON. Because of the increased complexity. To carry that one step further, there exists again some Fed policy that could produce the same result, but in order to do it, it might require augmenting the money supply sufficiently to bring interest rates down even lower. Then what you are saying is, that with some timelag that would lower the costs of total debt. And one could produce a figure that would represent the same reduction in the cost of the debt.

In other words, there exists a large number of alternative policy mixes to achieve the same result. I would reinforce the argument that, if the main motivation is stability, I think it is a mistake to attempt tax reform as a means of accomplishing it. Because, from a practical political standpoint, which you surely understand better than I, although you present a particular analysis of what in your judgment are the money and capital market effects, I can think of seven or eight alternative interpretations. Proposed tax reforms would lead to very prolonged discussions. When you change the structure you are changing people's positions, regardless of the merit of closing the loophole, and of course Henry Simons proposed that way back in his book "Personal Income Taxation," in 1937. So that has been a proposal that has been extant for some 30 years at least. Certain people have been aware of it. Yet the gestation period for getting it translated into action has been a rather long one and I wouldn't look with confidence therefore for achieving it in any short period of time. And if stability is the aim, I would much prefer to move in the direction of not doing anything about structure at the moment, and work on it for its own sake, hopefully to get it enacted any time it could be enacted, if it has merit.

Point No. 1, of having the 6-percent surcharge ready to go and just have another resolution of Congress to implement it is certainly a step in the direction of achieving faster reaction time, which was the brunt of the first part of my argument. I think there are still elements of inflexibility. This is a prejudgment that 6 percent is the right figure, and it doesn't do anything from the longrun standpoint of increasing reaction time to improve the ability to achieve greater flexibility in the mix of dependence on monetary and fiscal policy.

Mr. SAMUELSON. I want to second such a recommendation, if it were politically feasible, to have Congress pass any day now the 6-percent increase, but to go into effect only by congressional resolution. I think that would also have very powerful effects on the capital market and on this hardening of long-term interest rates which has been going on. Because as long as the market thinks, with an election year coming up, tax rates won't be increased, you get an intensification of their apprehensions in this regard.

I might also say that although in principle I would like to see the Executive get some discretion, I know from experience in this decade how difficult it is to win popularity for that cause in the Congress. There has been some reason to think that a halfway proposal like the one you made would not be completely unacceptable to all Members of Congress. I may refer to some discussions in 1964 on this matter, and if the Congress were for it, I would say it would be a very good thing.

Chairman PROXMIRE. Mr. Brock?

Representative BROCK. Thank you.

I would like to just briefly say I appreciate the gentleman from Wisconsin's concern with closing these loopholes, and I think we have a very excellent prospect of doing it the day the gentleman in the White House begins to talk about oil depletion allowances.

Chairman PROXMIRE. This could be announced from the ranch.

Representative BROCK. The day that it is, I think we will begin to close some loopholes. In regard to your comments, gentlemen, I was interested, Professor Samuelson, in your analysis of the prospects for our GNP growth in the balance of the year. If, as you say, it goes from $4 billion in the first quarter to $15 billion by the fourth, I would like to ask this question: With our plant capacity operating in the neighborhood of 87 percent, with a 40.3-hour workweek, the lowest in quite a while, with no productivity increase over the last several months, how much absorbative capacity do we have for this increase in GNP without any real price pressure?

There obviously must be some capacity to absorb. How much can we absorb?

Mr. SAMUELSON. You are asking about the most difficult question that can be asked of an analyst to get a good relationship to predict price behavior from the macroeconomic totals. I think that there are a number of favorable considerations. All I can do is give you a catalog of favorable and unfavorable considerations.

A number of the favorable considerations have been mentioned earlier by members of this committee. I would like to call attention to the fact that there is something like a world recession going on.

Chairman PROXMIRE. Something like a what?

Mr. SAMUELSON. Like a world recession in Europe. We have not caught the plague. It is not an old-fashioned depression, but for the first time we can no longer say that the mixed economies like Western Germany have not shown a recession in 15 years. The point of this is that there has been some pressure taken off the aluminum markets of the world, some pressure taken off the copper markets of the world, so that a number of basic raw materials are in favorable position. With respect to productivity, we have reviewed the capacity situation, and so forth.

So, if it were just a matter of going from a $4½ billion in the first quarter to $9 or $10 billion in the second quarter, and $12 billion in the third quarter and $15 billion in the single fourth quarter, I would not be so concerned that that behavior itself would accentuate price pressure. We might have some price pressure regardless of what we do, from food and from delayed effects. But most of the forecasts show a certain apprehension going into 1968 of $15 billion per quarter month in GNP on the average, or worse. And when that happens, I think that our luck will begin to run out with respect to price behavior.

I happen to be of the view—I shall be frank and not say that it is a majority view among economists—that the wage-price guideposts have had a substantial effect, and that in previous recoveries of the magnitude we have had under an economy, such as we had in McKinley's day or in the 1920's, or even prewar, you would have a lot more price increases than you have had. So that I think business has shown restraint, but I don't think you can count indefinitely upon that restraint. The more months go on with a new wave of resumption of demand, I will just have to say that my betting odds are that there is danger that basic wholesale prices will begin to rise and that profit margins will begin to be restored.

Representative BROCK. My point was that when you are operating, as you said, not at a low level but at a plateau level where we have, for various reasons, kept these employees on rather than turning them loose and having to go back in the market when we need more; by keeping them on we are in a somewhat different position, because we can absorb a pretty good increase in demand simply by increasing the productivity of these workers. We are not out competing with all countries. Each country is not competing with the other on the open market for workers, thereby driving up wages.

The basic problem, to me, at the moment and for the next several months is not so much demand but costs. And I think our currently important negotiations are of significance in this respect, as they affect inflation or prices. That kind of cost pressure is not so much influenced by a tax increase. It would be more affected, frankly, by wage price guidelines which we provide.

Mr. SAMUELSON. I think there is much in what you say that I agree with and would emphasize with you. On the other hand, in wage negotiations there are two sides: labor pressing and management resisting. If management were of the opinion that a very strong burst of demand is ahead of us, I think that would change the militancy of its collective bargaining and its attitude with respect to work stoppages and other matters. I can't candidly shrug off that consideration. There are a number of reasons to be concerned about what is just around the corner. I am not concerned so much, for example, that housing starts, which have shown a slight increase, will be chocked off the rest of this year to a level like that of last year, because commitments are made in advance and a good deal of the money is now in hand to support the current level and perhaps something a little better. But you could have a crunch in housebuilding again next spring if these forecasts are right.

I also would like to mention that the money supply—although none of your witnesses in February seemed to recognize that the element they considered to be vital was then taking off—has been growing at a very rapid rate. Corporations have been trying to restore liquidity. Savings and loans have been trying to restore liquidity. Banks have been trying to restore liquidity. That is perfectly understandable from their viewpoint. They want their freedom next fall. But from the standpoint of the macroeconomy, we cannot let them have this freedom. They cannot be permitted at that time to add at will to what may be inflationary pressure.

What concerns me is this: the increase in the money supply which right now is simply feeding an increase in liquidity preference and is not itself currently inflationary, money supply will be in the system 6 months from now. Its velocity could change at that time. That is one of the reasons why I warn you that if I have to come back and testify next spring I may be defending the Federal Reserve, when it is sopping up money and letting the rate of change of the money supply fall below 2 percent and below 1 percent, and even perhaps for periods of time to be negative.

Representative BROCK. When you start talking about monetary policy, I think one of the problems last year was the out-of-kilter management of fiscal versus monetary policy. Today we are talking about a tax increase, but nobody is talking about the monetary situation and I am not sure that it is time to slow down the input of money. But it certainly is flowing in. We have a very expansionary monetary policy today.

Do you have any thoughts as to when this should begin to trail off, if at all? Should we let it flow?

Mr. SAMUELSON. I would say that if the economy develops according to the timetable that is seen here, that probably you will find that the degree of monetary ease as measured either by the rate of change of the money supply or by various interest rate factors will begin slowly to change in the direction of tightness. Indeed, it may be that I am a poor reporter of what has already happened. When we look back, it may have already happened.

Mr. WESTON. I would like to comment on this. There is a curious asymmetry between the judgments we take with regard to fiscal policy and monetary policy. The general view is that it looks like we may need to have the tax increase and let's get ready and let's get ready to move fast with it. On the other hand, if it is indeed true that we will be getting in the area of $13 billion to $14 billion increases per quarter in the second and third quarters of the year, then people may well look back and comment in early 1968 that the Fed should have moved to tighten, let's say, as of this point.

You get a curious asymmetry, as I say, in saying "Well, we are not certain enough about the economic outlook to say that we should have a tax increase to go into effect as of a certain date." Yet we are inclined in retrospect to criticize the Fed for not having moved with some omniscience that we refused to say we have at this point.

There is another element that emphasizes asymmetry from a political standpoint. We look with apathy upon a proposal of the kind that I have made, even though I distinguished between tax structure and overall structure saying, "Congress just isn't going to give that power to the President."

On the other hand, the implication of this is that we will tend to lag even though we may get some speedup by the device of enacting and then implementing by congressional resolution. This means we still have some lag in the implementation of the tax side. This means that we relatively would then lean more on monetary policy in the mix, and what Professor Samuelson's discussion has brought out again very clearly is the problem of the inherent lags you tend to get in monetary policy that are underscored by the present situation, because the anticipations of a credit crunch in the fall have produced a credit crunch at this present time. Efforts to alleviate that increasingly have resulted in putting more liquidity into the system without affecting current interest rate levels. That increased liquidity makes us more vulnerable to inability to control an increase in the aggregate demand, if it should come on strong in the fourth quarter or the first two quarters of 1968, and would therefore require either more prompt tax policy to offset. But you might say, "Well, again, there exists some Fed policy in the direction of the negative rates of increase or decreases in the money supply, to offset the excess liquidity that was built into the system."

But then predicting the lag, the rate at which this can go into effect is quite difficult in terms of how much excess liquidity is built up now and then the tradeoff in the minds of the decisionmakers as to how much decrease in liquidity they are willing to accept versus changes in their current spending patterns. You get into some rather difficult lead-lag relationships as a consequence.

Representative BROCK. Thank you. My time is expired. I would like to pursue it. I appreciate it very much.

Chairman PROXMIRE. Professor Samuelson and Professor Weston, we have had testimony in the past 3 days which suggests roughly the economic system to be as follows:

No. 1, we have a very modest rise in investment, that is investment in plant and equipment, investment in inventories which may be even negative for a little while longer.

No. 2, an increase in consumption that at most will not exceed the rise in income.

No. 3, a lower level of housing than was expected earlier this year.

No. 4, a sharp rise in liquidity preference.

And, No. 5, the likelihood of a much bigger deficit than we had expected.

Under these circumstances, it would seem that our main concern may very well be with the credit market, with the so-called credit crunch, and under these circumstances, I just wonder if the best approach to this is a 6-percent increase in the surtax or if we have just frozen on this particular symbol and either it should be a larger increase in the surtax or it shouldn't be a surtax increase at all.

For example, I can see some argument for saying that, since this is a problem of capital demand, that the reinstatement of the investment tax credit would be more appropriate.

Would you comment?

Mr. SAMUELSON. First, I would like to say that I agree with each of the points that you enumerated, but I think that the whole is equal to the sum of *all* its parts and not just part of them, that any responsible macroeconomist in appraising the testimony that you have heard and putting it in the context of estimates, would also point out a very considerable increase in defense spending, in Federal spending.

Chairman PROXMIRE. I said a substantial Federal deficit.

Mr. SAMUELSON. I want to emphasize the resource use that is involved in that. In fact, most of the increase in the deficit—I would like to make my testimony clear on this—is not due to underestimation of tax receipts because of the unforeseen weakness in the economy. Perhaps $2 or $3 billion might be that.

Most of that is an increase in expenditures not budgeted for in January by the Federal Government. So I guess I don't believe that our only problems are in the capital market. I think that around the corner there is reason to be apprehensive that we will have problems with respect to the flow of aggregate demand.

Chairman PROXMIRE. Let me interrupt at this point to say that I don't know about the analysis that most of this is in the nonbudgeted for expenditures of the Federal Government because we are going to have a substantial dropoff in revenues from corporation income taxes and maybe some from personal income taxes, but a big element here is that we may get a $5 billion increase and maybe more in Vietnam.

Chairman Ackley said that he didn't see any reason to change that position at all. A big element is this bookkeeping thing which is very, very hard for me to understand, if it has any economic implications at all; that is whether we are able to sell participation certificates which the President recommended. He recommended the sale of $5 billion worth of assets. I can't see that that would have any real significant economic impact, simply a bigger deficit, but not much change in utilization of resources.

Mr. SAMUELSON. I perfectly agree that the problem of participation certificate sales is part of the sham bookkeeping that is just part of the guerrilla warfare that goes on between Congress and the Executive. I don't give it my blessing at all.

I have here the estimates of the budget on a national income accounts basis which is what busy economists who haven't time to waste tend to concentrate upon, and this shows in January an estimate for the year of minus $2 billion, whereas the latest estimate is anywhere from minus $8.9 billion.

Chairman PROXMIRE. What is this again?

Mr. SAMUELSON. This is the latest estimate for fiscal 1968 of the deficit on national income account.

Now, I feel a little bit like J. P. Morgan who had a midget put on his lap. A member of your staff thrust this into my hands to correct the impression I gave, so that I believe that this is from a speech by Mr. Proxmire.

Chairman PROXMIRE. That is right.

Mr. SAMUELSON. I don't vouch for my understanding of the source, but if it is from a speech by Mr. Proxmire, I will vouch for its accuracy. This shows the difference in expenditures.

Chairman PROXMIRE. You shouldn't exaggerate.

Mr. SAMUELSON. The expenditure side of it is only an increase of anywhere from plus $1 billion to plus $6 billion. I should also mention, of course, that the January estimate was premised upon the 6-percent surcharge as of July 1, which a logician might say is exactly the issue which is under discussion.

Mr. WESTON. I think the total picture has to be taken into perspective, too. I think that you had a greater GNP rise in 1966. It should have called for fiscal and monetary restraints. You didn't have fiscal restraints. You had very strong monetary restraints to try to head it off. This produced the credit pinch in the fall of 1966. It also produced a leveling off in the private sector from two forces: One, that the rate of increase in the private sector was sustainable only if the rate of increase in total GNP continued, and it logically couldn't, and Federal policy saw to it that it wouldn't. Thus, you began 1967 with a pretty clear pattern that there wasn't much strength from the volatile sectors of the private economy.

Chairman PROXMIRE. From the what?

Mr. WESTON. From the spending segments of the private economy such as inventory investment, consumer durable goods that would have multiplier effects. There was no strength there, but the strength, if any, would be coming from Federal Government deficits.

We have gone through the first quarter of 1967 where the main reason for the small increase in GNP was in the $11 billion drop in the rate of inventory cumulation. You have the May 1967 McGraw-Hill survey that at least 80 percent of the inventory cumulation had been accomplished in the light of the mixed feelings about the behavior of the economy in the first and second quarters.

Incidentally, you get hard evidence of the resumption in strength of the economy in the third and fourth quarters. You may well get increases in inventory cumulation; that is, net positive effects on the economy, from inventory cumulation in the third and fourth quarter. Even with continued negative influences in the economy on into the third and fourth quarter, as you get the impact of increased Government spending, you get these $14 and $15 billion increases in the economy in the third and fourth quarters.

Chairman PROXMIRE. Let me interrupt to say that I think we are getting into a very, very interesting area to me because it suggests that if we have an increase of the kind that Senator Stennis, for example, suggested that he thought we would have, and he has been right in his predictions before, with $5 billion or $6 billion more spent in Vietnam, with all that implies for the economy, then very possibly there might be a stronger argument because of the economic, not the budgetary, effect of that, a stronger argument for a tax increase.

Now, what that also leads me to contend is that we had an increase in spending from 1966 to 1967 from $106 billion to $125 billion. The expectation is, and I stress expectation, according to the President, that we would have an increase from $126 billion to $135 billion in the coming fiscal year.

However, we all know how these supplementals come in and if we have this problem in Vietnam, we will have at least another $6 billion and perhaps more from other spending elements.

This is why I argue that we can perfectly properly consider as an alternative also for the tax increase, at least in an academic sense, a shaving of the recommended nondefense spending. If, for example, we should defer spending on roadbuilding of $3 billion, if we can defer spending on some of the big dam projects, and so forth, around the country, if we cut back the space program—and Congress has already recommended that it be cut back between $300 million and $400 million within the last couple of days and we haven't even got to the appropriation process—if we can reduce our troop commitment in Europe which was the unanimous recommendation of the Democratic policy committee in the Senate, that one recommendation would save a billion dollars.

If we follow policies of this kind this would accomplish the same thing as an equivalent increase in taxes without some of the problems that an increase in taxes represents, and maybe they are very peripheral, but the increase would mean corporation taxes passed on to some extent in higher prices, an increase in taxes to labor union members can be passed on to higher wages and higher prices. So I think it is perfectly responsible and proper and not rating a C or D grade for us to contend that a spending reduction may well be an alternative that should be considered or possibly something that can go as an alternative to a tax increase.

Mr. WESTON. May I lead off on that?

It seems to me that this is the curious kind of argument that we hesitate to recommend a tax increase because this would reduce the ex ante deficit and we are not certain that the economy is strong enough to take this.

On the other hand, we assert with more confidence that we are willing to aim for the same ex ante decrease in the deficit by cutting spending. So it seems to me that there is a paradox.

Chairman PROXMIRE. That isn't what I said. What I said was that it appears that we may get a further increase, unbudgeted, unexpected, in the Vietnam war area and other areas. We don't know if we will get it or not. The President did not make a commitment. McNamara didn't go to Vietnam when expected. If he makes the decision to escalate 100,000 troops and we need the $6 billion, you can get it by increasing taxes by $6 billion or cutting other spending by $6 billion.

I am saying that we ought to eliminate all unnecessary spending. I am not just saying that. I am saying that we can make certain postponements, especially in the capital investment area, under these circumstances that might very well serve as a substitute for increasing taxes.

Mr. WESTON. My argument there is that this must necessitate the recognition that you excite the same macroeconomic effects. Any degree of uncertainty expressed about the timing is subject to the same reservations about the economic outlook. But it seems to me that it boils down to the fact that the decision then depends not on the macroeconomic effects or even the money market effects, because I think these can be handled, but the decision should be based on the argument that the priorities of individuals spending those funds which they would be enabled to do if you didn't have the tax increases have higher priorities than these capital budget programs of the Federal Government. It seems to me that this requires a different analysis other than the one you mentioned of troop commitments in Europe, which involves another set of analyses in terms of diplomatic-military considerations, which requires another kind of analysis.

Chairman PROXMIRE. Congress is capable of making this kind of judgment or at least they are going to make it, but what you gentlemen can tell us is the economic wisdom of it.

Mr. SAMUELSON. I would like the record to show that I gave nobody a C for saying that in time of inflation a reduction of Government expenditure has the same economic depressant effect as an increase in tax expenditure would have. I agree with the mechanics of that proposition. I do not regard any element of expenditure as sacrosanct, and when there is strong inflationary pressure and a shortage of resources, I think that is a good time to scrutinize marginal Government expenditures.

I approved a decision in 1966 to defer military barracks construction in the United States, particularly after Congress made the judgment and the President made the judgment not to ask for the tax increase at the beginning of 1966 that I favored, accepting this as a fait accompli. I think that there are deferrable items in public expenditure and that the margin and decision should be changed in favor of tightness when the economy is tight.

The chairman might have been out of the room when I expanded on what I detected was asymmetry in the treatment of taxes and fiscal policy in the various reports, and the only marking down I gave, for the nonsequitur was: the economy is too weak to afford a tax increase, therefore cut expenditures. I thought that was bad committee reasoning with some honorable exemptions.

Chairman PROXMIRE. I don't think we said that. If we said that, it was certainly wrong, and I certainly accept that, but I don't think that is what we said.

My time is up, but if Congressman Reuss will permit, I would like to impose on him to ask you if you would comment on the nature of this instrument of a surtax. Is this what you feel would be best? It has the advantage of being neutral, something you can knock down promptly, but is it the best instrument to cope with the kind of economic problem that confronts us of demand which isn't too exuberant but of this liquidity preference problem and the shortage, perhaps, of capital? Is there some other way that we can get at it better? Some other tax instrument or something else?

Mr. SAMUELSON. In my judgment now, and I think I am repeating something that was said in your absence, across the board a more or less equal percentage surcharge of 6 percent, plus or minus, would be an appropriate and rather politically acceptable move if the economy does develop, as many forecasters believe it will, excess demand-pull inflationary tendencies.

This will not take care of the capital problems, and I would hope that the overdramatic word could perhaps be avoided because it drives away thought. The word "crunch" has become so popular a cliche that it is a substitute both for thought and for description of something. We are now using crunch to mean a tightening of money.

The original use was the near crisis which some people thought they detected in the capital markets in late August or September of last year. I wish that more time were devoted to analyzing exactly what that crisis consisted of and what the probabilities of resumption of it would be.

I think there is considerable probability, fractional, not certainty, but considerable probability, that we are going to go all through this once again in the next year or so.

Mr. WESTON. Since corporations have had this same fear, they have built up liquidity. So I think two things are fundamentally different as you look to the fall of 1967 as compared to the fall of 1966: No. 1, you have considerable liquidity already achieved. No. 2, a readiness and apparent willingness on the part of the Congress to enact an increase in taxes which would put less of a burden on monetary policy to restrain any overexuberance in the economy.

Therefore, I am inclined to feel that this great fear, the demand-supply relationships in the money and capital markets would be such that you would get a very substantial rise in interest rates in the autumn from present levels, is unlikely to occur because you have already had a rise to very substantial levels in the long-term rates at this point.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Weston, you spoke earlier of the differential between present short-term and long-term interest rates. It has been somewhat disturbing to me that short-term interest rates below 4 percent on Treasury bills for example seem to me almost unnecessarily low and particularly in a balance-of-payments deficit situation and long-term interest rates which have hardly come down at all from their peak of last August seem unnecessarily high in terms of what they do to the housing industry, small business, State and local borrowing, and so on.

I think you said that the Federal Reserve System could have done more than it has done to bring longer term interest rates down. Did I hear correctly?

Mr. WESTON. I asserted that the Fed does have the power to affect long-term rates, but this involves some cost, too. The point I am making is that, given some increase in the money supply, the volatile segment of the demand and supply relationships in the money and capital markets are on the demand side and the private sector is not interested in building up 3-month liquidity. They are interested in building up 12- and 18-month and even 3- to 5-year funds, which means that from their own standpoint they are going into the long-term bond markets to build up funds which won't run off and won't be subject to the necessities for repayment during a 5- or 10- or 15-year period of time.

Representative REUSS. I think that the Fed deserves a little criticism for not responding more than it did. You know the Fed back in 1961 or 1962 iormally renounced its "bills only" policy or "bills preferably" policy and said, "From now on we are going to buy across the spectrum."

I checked the figures the other day and what happened is that after a few months of adherence to this new policy of rejecting bills only, the Fed went right back to, using Mr. Samuelson's term, "its same old snake oil," and has really been on a "bills only" jag for some time, with a result that its $3 billion portfolio today is lighter on the long side than it ever was in the heyday of "bills only."

I am wondering in a broader purchasing policy, when they increase the money supply, why not give it across the board instead of just on the short end? I am wondering if such a policy wouldn't have produced a better structure of interest rates today to the help of the housing industry and so on.

Mr. WESTON. In stating that the Fed could reduce long-term rates, I was disagreeing with the proposition that they cannot, but I was not necessarily criticizing the Fed's decision not to. I think these are two separate issues.

Representative REUSS. However, shouldn't they have, and shouldn't they now? They are, in the last few weeks, now buying a few long terms, but shouldn't they really rid their intellectual storeroom of this "bills only" notion?

Mr. WESTON. I make two comments on that.

One, when the Fed operates in the long-term market and produces changes in supply relationships there, and when taken in conjunction with demand relationships produces yield or price effects, the impact—since they are long term—is greater than the presumed impact in the short-term area. This accounts for the tendency to operate in the short end and therefore makes for a more viable Government bond dealer market and reduces the risks of being a Government bond dealer, and hence presumably makes the long-term markets operate more effectively.

Again this could be analyzed at length as to whether, when you consider second and third order effects, whether it does really produce this or not.

The second point I wanted to make is that these are not compartments. They are not sealed off, the short and the long end. In increasing the supply of funds, given the very strong demand for liquidity in the long end of the market on the part of corporations and a lack of desire to borrow at short term, in order to bring down long-term rates, would require a large infusion of the total money supply on the part of the Fed. This could potentially represent some problems in excess liquidity in the system when you wanted to put the brakes on in a period when demand was exuberant.

So there would be some costs to the attempt to bring down the long-term rates at this point in time. This is not a free good. I think this has to be recognized.

Representative REUSS. Professor Samuelson, would you like to comment?

Mr. SAMUELSON. I criticized the Fed prior to 1950 for its "bills only" doctrine. I applauded its 1960–61 recantation of that. I recommended Project Nudge or Twist in the 1960's. But when we look at what was done in the 1960's quantitatively, not a great deal was done—particularly since we had a very resourceful Under Secretary of the Treasury who popped long-term bonds into the market every time there was an opportunity, so that he was undoing the Operation Twist as fast as anybody was twisting. However, constructively, the Federal Reserve has been buying in the long market in recent weeks. I think it should continue to do so in this period of hesitation and doubt. It should be encouraged by Congress in this since it is inside the Government, but not dependent on the Government. And I would call your attention to Mr. Gaines' testimony before you yesterday, a banker from the First National Bank of Chicago, who said that it would be more effective if they did it steadily and let the market know that they were going to do this for a period of time.

Having said that, I should add that the present Under Secretary of the Treasury who is inside Government and not the creature of Congress, should not be encouraged and given good marks for lengthening the debt at every possible opportunity.

That has been an aberration of Chancellors of the Exchequer for a century. They consider themselves as doing a good job whenever they lengthen debt maturity; but that is not a good way for us now. We should not use any lull for the purpose of lengthening the debt.

It should be said that there is evidence that it is not easy to do much twisting and that it will take a large amount of buying at the long end and selling at the short end to create much of an effect. Morover, the time may be very soon here when our concern will be whether the short rate is going to stay as short as it now is.

I may say that I don't agree that at the moment there are international repercussions from it. Because of the slowdown in Europe we are more free from that constraint than we can hope to be in the longer run. The current excess of long yields over short, is likely, I am afraid, to be reduced by an increase in the lower end of the anchor unless matters change.

On the other hand, if the economy is weak—if I could accept, for example, the implicit forecast of the Fortune Magazine Roundup which is that the economy is going to be weak for a couple of years—I would not be concerned about the hardening of long-term rates that is taking place right now because what is done can be undone, both by the expectations of the marketplace and by the Federal Reserve, and can be undone prudently.

But the market is not now behaving stupidly. If it believes that in the first quarter of next year there is going to be strong inflationary pressure, then the time is now for that to be recognized in the long-term rate. So the differential mustn't be thought of as an aberration. The market will change its mind as events change.

Mr. WESTON. Let me just say a couple of sentences on that.

By and large, you get this steepness in the yield curve when there are expectations that future interest rates will be higher because the strong demand is on the long term end and not on the short term end.

Conversely, having reached some high level of interest rates, this expectation that interest rates will be still higher in the future begins to subside, and you tend to get then a flattening in the yield curve which provides an expectation which provides a basis for predicting of less pressure and possibly some easing off even in the long rates and a rise in the short rates. However, if you have a long period expectation that money markets are going to be tight and interest rates are going to rise in the long run, then you would certainly have a continuation of a rather sharp yield curve.

Mr. SAMUELSON. To bring the devil right out in the open, if people really think that we are in for a long-term inflationary period where prices, instead of rising for the Consumer Price Index at 1 or 1¼ percent, which may not really be a general increase at all, but instead are going to be rising at 3 percent, then you will get built into the interest rate structure an allowance for the change in the value of money and then the *money* rate of interest may look high, but the *real* rate of interest of what is actually earned will not be all that high.

We have seen this in Brazil and Chile and places of chronic inflation. Of course, we are nowhere near to those situations, but probably already there is something in our interest rate structure as an allowance for normal, manageable mixed-economy inflation. That premium could increase.

Mr. WESTON. Right, and I think the implications are that you get expectational effects at that time at the average level. The yield curve would be higher and it would tend to be steeper.

Representative REUSS. I wanted to pursue with Mr. Samuelson what we talked about before, namely, the desirability of the Government's getting hold of additional revenues by loophole plugging in a situation like that prevailing today where we are fairly close to a full employment without inflation, but we are faced with a big deficit.

I think you said, Mr. Samuelson, that while, of course, loophole plugging is a worthy endeavor at any time and you are for it, you don't see any particular desirability of it now because, as you said, if we are at a situation where demand is just about right, close to full employment but not over full, and we are facing a budget deficit, there is no particular advantage in trying to avoid that budget deficit by plugging loopholes and raising the revenues that way because, you pointed out, the Federal Reserve, if loopholes are not plugged could simply increase the money supply by an amount necessary to float the additional Treasury borrowing.

Is it really that simple? I would be afraid in the model we put that the Fed, if forced to that act of additional monetary creation, would have created an inflationary overhang which, in a period immediately ahead, on an assumption of an economy just in balance, would cause inflation, and I put it to you that there is an added virtue in loophole plugging in a time like the present when we are at a full employment without inflation situation from the demand standpoint but are facing large budgetary deficits in part brought about by the existence of these tax loopholes.

Would you come back on that?

Mr. SAMUELSON. May I throw you a crumb?

Representative REUSS. I need one.

Mr. SAMUELSON. I think as far as the Gnomes of Zurich are concerned and those people who have a less radical attitude toward the public debt and deficits than has been displayed by most of the witnesses before you, there is a psychological worry about the deficit. Aside from its economic importance, there is a psychological worry about it.

I think $3 billion of legitimate revenues which we ought to get from anywhere would do something to reduce that psychological worry, and I offer that to you as a special reason for plugging loopholes in this year of high deficit.

Representative REUSS. The Gnomes aside, what about the numbers?

Mr. SAMUELSON. I took the extreme case for classroom simplicity where all of the loophole people who have constructive realization of capital gains have the money at the outset in greenbacks and pay it over in greenbacks. Then I don't see that there is anything more or less inflationary in having the Federal Reserve create those greenbacks anew than to have these greenbacks which were in somebody's hoard coming into circulation and increasing, as you said, inflationary pressure.

But, of course, it is unrealistic for me to assume that this is all going to come out of hoards. So let's actually assume that this is held in so-called locked-in securities, and so forth.

Then I would say that to the degree that these people have to liquidate, have to find a buyer, that you are tightening the capital market.

Now, I don't know how important this is, but Professor Modigliani, my colleague, has been making extensive studies of what determines capital formation—I can remember our chairman once defending his reputation as a craftsman in a congressional debate—and he finds that the behavior of the stock market is an important determinant in his equations for capital formation. Therefore, loophole closing that required forced liquidation which had not been anticipated would be a stock market factor. You would have to send me home to do my homework to work out such effects.

I pray that you not do that, but I would be responsive to your command to weigh the very complicated incidents on the capital market of both sides of the transaction, the Treasury getting the money which it would not otherwise have gotten, and the people being able to provide the money.

I suppose we would have accruals and wouldn't insist upon immediate payment, particularly in the first years of this. It would be a very neat little problem in incidents about which it would be difficult to be highly specific.

Mr. WESTON. But I think the distinction is that it is equity versus impact on the aggregate economy and regardless of impact on the aggregate economy, this is where you have to do your homework.

In equity terms we agree that the loophole should be plugged, and if in a period such as this you get more particular political momentum to close the loophole, I would argue for it because even after you did your homework, I would predict that there would still be arguments on both sides as to whether this is better than something else.

But if on equity grounds it is desirable and the present timing enables us to get it, then get it by all means, and for whatever reasons that can be mounted to get the requisite political support to get it adopted.

Incidentally, I would like to make two other brief comments on other aspects. One, with regard to the steepness of the yield curve and the criticism of the Fed, I wanted to comment that our previous discussion established that the level of the yield curve and the steepness is very heavily a function of expectations about price levels in the future. In turn, this is a function of all kinds of Government policies. If the Fed reasons that this steepness will persist regardless of whether they are operating in the long or short, aside from day-to-day perturbations that might take place, then I think the Fed has a strong basis for a position of saying, "Well, we won't attempt to reduce the steepness in the yield curve in view of what is causing it, because the cost would be introducing excess liquidity into the system in the view of potential strength in the economy later."

The other comment I wanted to make is that it seems to me, Professor Samuelson, on your comment that in a period of excess demand essentially related to Government deficits that cutting out marginal projects as a basis for reducing Government spending is valid only if you are implicitly assuming that the Government marginal projects have lower productivity than market marginal projects.

Otherwise, I see no valid economic basis for cutting. If Government marginal projects, that is, marginal with respect to other Government projects, are higher than the marginal projects in the private sector, the Government marginal projects should not be cut out.

Mr. SAMUELSON. I think you misunderstood my argument. Let's imagine, to make it simple, that the Government has for reasons of Vietnam an increased need for a larger fraction of our full employment resources. There are less of those full employment resources available to go around for non-Vietnam purposes. What shall be cut?

I think that the prudent private household will cut something from each of its budgets, something from recreation, something from tobacco, something even from education, excellent as I know it to be.

Similarly, society will want to cut from the marginal capital formation. We do this by means of tightening our capital markets.

Likewise, when total civilian resources are reduced, will the prudent social household contract its nonsocial public expenditures?

I am so completely Galbraithian that I think there should be maintained an equalization of the marginal social utility of the public sector and the private sector; and when resources are scarcer, I believe that both of these margins are withdrawn.

I am not trying to be harder on the Government sector than upon any other sector, but I dissent strongly from a view which achieved prominence in my profession about a dozen years ago and which has since blissfully passed out of notice (1) that public expenditure is not something ever to be varied cyclically depending on the state of demand, whether it be the expansionary or contraction; (2) that you make up your mind what the proper expenditure is and you hold to that.

Just as I called it snake oil to think that in a changing world you can make up your mind in advance as to what the proper behavior of the money supply is, I think that all decisions are interdependent, and need changing depending upon wartime and other new demands for resources.

Mr. WESTON. With your explanation we are in agreement because in your explanation you point out that at the margin you are equating returns from marginal public and marginal private projects.

Chairman PROXMIRE. There is another interesting aspect of this thing, it seems to me. What I had always tried to get Senator Kerr to give us when we had our debate on the space program is what the space program is doing to scarce resources, what it is doing to manpower resources.

This is an immense research program of the kind we have rarely had in the past. If we reduce the space program, we may make more resources available for graduate education, for industry, for defense, in other areas. Unless we have the kind of manpower study I wanted to get and never succeeded in getting, although I introduced amendments, it is hard for us to make a sensible decision as to whether the space program is warranted at the very high levels at which it was being funded, and I argue now that, absent that, on the basis of everything I have seen and knowing about the scarcity of these very precious manpower resources, whether it would be good to pare it but recognize that from a macroeconomic viewpoint this is not only a saving of money but the saving of a precious resource.

I would like to say, Professor Samuelson, that it is my understanding that whereas you give us a C in part because of our failure to come up with a sensible recommendation on monetary policy and plug for a 3- to 5-percent increase in the money supply, I understand that your very good friend Professor Friedman gives us an A-plus in this regard. If we add up what the professors give us, we come out pretty well. You say he is wrong.

Mr. SAMUELSON. With respect, yes.

Chairman PROXMIRE. I would like to ask you this because this may be a consideration in our report.

One of you gentlemen said that one of the reasons for liquidity preference, one of the reasons for the credit demand now is because people don't know whether the taxes are going up or not, and assume they are not going to. Can we say anything more that would be helpful in indicating that the administration should act and that this uncertainty is having an adverse effect on the economy in any other area?

Mr. SAMUELSON. I would simply say that I think that an announcement that the administration wanted a tax increase accompanied by an initially favorable posture of Congress toward that would definitely be felt in the Government bond market.

I wouldn't want to exaggerate the lasting quality of that because in the last analysis the future pattern of interest rates is going to determine whether it is right for these corporate treasurers to be coming to the market in great amounts. By the way they are quaking in their boots and asking themselves, "Are we right to be issuing bonds at 6 percent that can't be called for 10 years?" At the moment they think things are going their way, but if it goes the other way, they are going to look bad to their companies. But what will make them heroes or scapegoats is whether the economy is so strong or weak in the future that the whole structure of interest rates is up or down.

The curve twists when you are uncertain about its future changes and have a particular slant about that change, but when you finally find out what the new level is to be, the curve becomes flatter than it now is.

Chairman PROXMIRE. Let me just ask finally: Do you conclude that, if liquidity preference is stabilized—and, Mr. Weston, you gave us the impression, or at least gave me the impression, that it may well be that demand and liquidity may have reached a stable point where it might not continue and we may not get an increased demand for capital from this source in view of the fact that there would not be a great demand for plant and equipment at an increased interest rate—then the thing shifts out from an intense concentration on higher interest rates and into the possibility that the end of the liquidity thing may be translated into a greater demand for goods.

In other words, they have the cash and so perhaps they won't save quite as rapidly, and the evidence does indicate that even if they do this we have resilience and can produce and grow more rapidly up to a point.

Professor Samuelson says $15 billion a quarter, roughly a $50 billion or $60 billion annual rate, is the most we can take without inflation. Does this indicate that if in this area we could get stability that would be it, and we might not have to worry about a tax increase or cutting spending?

Mr. WESTON. I think not. I think it goes back to a previous question that Professor Samuelson points out. If the administration indicated that they wanted a tax increase and if Congress indicated they would get it. That has been the problem because the administration asked for an increase very early, but after an initial reaction the expectation was that they were not going to get it.

It seems to me it takes an expression of a position by Congress to get expectational effects with regard to prospects for a tax increase. The question you posed I don't think can be answered simply. I think it has to be taken into the whole context of what is the degree and rate of increase.

Chairman PROXMIRE. The question I just asked really relates to whether or not we can anticipate a continued demand for funds. A continued demand which is short of the Federal Reserve engaging in even a more aggressive policy of increasing money supply could drive up interest rates.

The only apparent reason for this has been liquidity preference because you have indicated that the investment demands of various kinds are stable or declining or low.

Mr. WESTON. But I think it is a special kind of liquidity preference. I think it is not a liquidity preference that represents a flight from investment in assets because of a fear of a decline in the value of assets which was the context of the introduction of the concept of liquidity preference in the general theory.

Rather it is a liquidity preference in expectation of needs, either for working capital or for plant and equipment outlays. It represents a decision on the part of corporate treasurers that the costs of unavailability in terms of the impact on the effective functioning of the business firm, the costs of unavailability of funds of the kind they ran into in August of 1966, are much higher than the costs of being able to borrow long-term funds perhaps 1 or 2 percent lower in the next 2 or 3 years. This would be taken into account in the appraisals of these decisions by the corporate treasurers.

It is just not a matter of comparing long-term interest rates today with what they might be 2 years hence. This has to be compared with a set of alternative, general costs.

Mr. SAMUELSON. Could I say that I think $15 billion a quarter is on the high side of the danger point? I don't know if I quote Dr. Ackley correctly in his testimony before you a couple of days ago, but did he say that over $60 billion for the year would be dangerous and under $50 billion would be inadequate?

It seems to me that that is the right ball park, and if we pick the upper limit, that is a little bit on the danger side because that means a 7½-percent increase in the money GNP, of which a 4-percent real increase would be a commendable performance.

Chairman PROXMIRE. You feel satisfied with that 4 percent?

Mr. SAMUELSON. Well, as a predictor, I would say the 4 percent would probably be doing well under those circumstances at this stage of the game and that gives you a 3½-percent increase in the GNP price deflator.

Chairman PROXMIRE. That is too much.

Mr. SAMUELSON. It could mean at times wholesale prices and consumers' prices going up at 5 percent annual rate even if not every month. So that is a bit on the high side. I think I agree with you on the analysis of the demand for money in this period. If the economy were to limp ahead for another four quarters after the middle of this year, at something like the recent pace, then I think there would be a massive and agonizing reappraisal by the money markets, and you would find the long-term rate coming down because these people, as I say, who are hastening to borrow and restore their liquidity are not actually using it in an exuberant way on plant and equipment. But we must also remember that their profits are going down while their dividends are not, so that there is getting to be a bit of a money squeeze.

What they are presumably doing is borrowing this money long, and because they have no use for it immediately they are paying debts or buying short-term bills, which is giving the twist to the yield curve. And all that could untwist itself if the economy stays weak.

But that won't happen if we begin to go to above $15 billion quarterly GNP increases as could happen. In that context you may find the Federal Reserve tightening even if you give a full tax increase.

I don't think that the testimony before you in February and March was very relevant about a "deal" between the Federal Reserve and the administration. That is not the way these things are done. The relevant consideration is whether if the administration raises tax rates, the Federal Reserve can be counted on to see that this does not kill off full employment but rather merely improves its mix. This doesn't mean that the Federal Reserve hasn't learned a lot.

I think the Federal Reserve has shown much better behavior than it did in the 1950's. I think that Congress has had something to do with that improvement in report card performance.

Chairman PROXMIRE. Thank you gentlemen, very much.

I would just like to ask both of you if you would encourage your bright candidates for a doctorate at MIT and UCLA to consider very seriously working on wage-price guidelines or developing an incomes policy of some kind. This is a puzzling, trying policy. Since 1961 the wage-price guidelines were most helpful, I agree with Professor Samuelson, but we have stumbled into a very serious problem because of what inflation did with them. If we can solve that, it will be a great contribution to a better society.

Thank you, gentlemen, very much.

This concludes our hearings for the time being.

(Whereupon, at 12:55 p.m., the joint committee recessed, subject to call.)

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