PRIVATE SECTOR CREDIT AVAILABILITY

716

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PRIVATE SECTOR CREDIT AVAILABILITY

THURSDAY, JULY 17, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1224, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Javits; and Representative Long.

Also present: Jerry J. Jasinowski, L. Douglas Lee, George R. Tyler, professional staff members; and Michael J. Runde, administrative assistant.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. The meeting of the Joint Economic Committee will come to order.

This is the third of four hearings by the Joint Economic Committee on the subject of credit availability. Earlier we heard from the housing industry and State and local governments. Today we will focus through the testimony of our witnesses on credit availability in the private sector generally.

There is an overwhelming body of opinion among economists that the money and credit policies of the Federal Reserve Board have either been responsible for or contributed in a large measure to the depth of our current economic slump. By drastically reducing growth in our money supply in the last half of 1974, allowing the money supply—the availability of credit—to only increase at an annual rate of about 1 percent, the Federal Reserve forced interest rates up to historic highs, thereby choking off investment, and forcing down an economy that was already on the decline throwing millions of people out of work, and causing general dislocation in our economy.

At the same time that it pursued this extremely tight monetary policy, the Federal Reserve Board took upon itself to arbitarily allocate credit to some sectors of the economy. I noted with considerable interest in the Congressional Record of April 24, 1975, the statement of Mr. Brimmer, which I inserted, on the subject of financing the deficit. Mr. Brimmer points out that the Fed has from time to time, literally by its telephone calls, its letters, and its recommendations to the banking industry, and particularly the large banks. allocated credit to some sectors of the economy.

This is not to say that some of those sectors did not need it. For example, Mr. Brimmer points out that there was a determined effort to allocate substantial amounts of credit to the cattle feeders at a

time, of course, when cattle feeders needed some credit. My point is that the Federal Reserve can allocate credit if it wants to.

I would also take note of testimony by Mr. Brimmer carried in the February 14, 1975, issue of American Banker. The article on page 6 of that issue reads:

> As the committee knows, while the Federal Reserve Board has been strongly opposed to any formalized system of credit allocation by commercial banks, the board in fact has been doing just that. Last year the Board, primarily through the reserve banks, took an explicit and active role in counseling commercial banks with respect to loans to real estate investment trusts. The reason for this was straight-forward under a policy of severe credit restraint followed by the Federal Reserve system in the face of the strong inflationary pressures. Many REIT's could not roll over the large volume of commercial paper they had issued to finance their operations.

And it goes on to explain a little more.

That again is Mr. Brimmer's comment. He served, of course, with distinction as a member of the Federal Reserve Board.

Now, if we are to have credit allocation by the Fed or anyone else, the rules of the game should be explicit and systematic so that we can avoid back door bailout, and so that we can avoid the situation where unelected government officials have the power to save or bankrupt firms in arbitrary fashion. This is especially true when these same officials resist efforts by Congress to press for an open and clear policy of credit allocation.

As you know, the burden of tight money fell most heavily on housing, small business, farmers, and State and local governments. And as I said, while rejecting formal credit allocation to aid those hard-pressed sectors, the Fed did pursue its own policies of credit allocation.

Now, because of its past record of credit allocation, I believe that Congress must scrutinize much more carefully Federal Reserve policies. That's one of the purposes of today's hearings.

But there is a broader reason for this hearing. Congress is making some progress in influencing monetary policies as a result of the Proxmire-Humphrey monetary resolution. But there is still a long, long way to go. As part of their effort, the Joint Economic Committee conducts a continuous review of the adequacy of monetary policy in promoting economic growth and price stability.

The most immediate concern here of course is to assess whether the Federal Reserve Board is pursuing monetary policy that will accommodate a strong economic recovery.

And let me divert from my prepared remarks to say that on my recent visit overseas I find that in Denmark, for example, that the central bank is adjusting its money supply rate to the necessities of the economy. And, of course, this is true in the Federal Republic of Germany, and it is true in France. And yesterday some of us had the privilege of meeting with the former Finance Minister of Japan. The very same thing is going on now in Japan; and indeed, as we were told yesterday, in the month of September there will be a further effort made, because Japan is suffering an unemployment rate of around 5 percent.

Of course, that is a shock to the Japanese. Our Government now views a 6-percent unemployment rate as sort of an economic heaven; I must say I can't concur in that.

Now, the Board has announced a target range for growth in the money supply of 5 to 7½ percent from March 1975, to March 1976. I might add that that is about the first time that we have had any kind of formal announcement from the Board. And that had to be extracted by a painful method.

From the beginning of this year through June the money supply grew at about a 7-percent annual rate. We know, of course, that these rates fluctuate weekly and monthly. Their rate of growth is within the Fed's target range, but is far less than what independent economists have told this committee is necessary to insure a strong economic recovery.

The concensus of independent economists that we have surveyed and that have testified here is that a monetary growth of 10 to 12 percent is vital to accommodate a speedy economic recovery.

I should add that the Federal Reserve has been allowing the money supply to grow in this range since February, although some recent signs point to a reversal of this policy and a return to tighter money growth.

The implications of the Federal Reserve Board's choice of a monetary growth rate of 5 to 7½ percent for economic recovery are distressing. For example, a recent study by the Congressional Budget Office—and I would commend the report of the Federal Budget Office to your reading—found that a 10-percent growth in the money supply, instead of the Fed's 7 percent, would add $21 billion to real growth, increase employment by about 300,000, and fully reduce inflation because of productivity gains.

I think it is important that the public understand that productivity slackens off and retreats in periods of recession, rather than improving.

I believe this evidence makes a strong case for monetary expansion in excess of the Fed's target over the next year. I want to get the opinions of today's witnesses on this question of the adequacy of growth of the money supply.

In addition to this central issue of monetary policy, today's hearing will focus on other important questions, including: Are credit flows to specific sectors of the economy adequate?

Should the Fed be permitted to engage in arbitrary credit allocation?

Do we need explicit credit allocation procedures, and is the level of farm debt—and I point this out particularly to Mr. DuBois—becoming so large that a bumper crop, if there are not adequate exports, will force a large number of farmers to either bankruptcy or certain economic distress?

We have today with us Mr. Philip Klutznick of Chicago and New York; Mr. Lester Thurow of MIT; and Mr. Pat DuBois of Minnesota, representing the Independent Bankers Association of America.

Before we start, let me thank Mr. DuBois for conducting the survey of independents banks which he is releasing today for this committee.

Mr. Klutznick and Mr. Thurow and Mr. DuBois, we are going to have you as a panel.

We will start with you Mr. Klutznick, followed by Mr. Thurow, and then Mr. DuBois, and we will have the questioning after you are all through. We may interrupt you once or twice to try to get the points cleaned up.

Go ahead, Mr. Klutznick.

STATEMENT OF PHILIP M. KLUTZNICK, KLUTZNICK INVESTMENTS, NEW YORK, N.Y.

Mr. KLUTZNICK. Mr. Chairman, I read the announcement of this hearing. And I'm identified in this hearing as a financial consultant. I'm not a financial consultant. I need advice rather than being able to give it.

I am, as you know, formally before this committee as chairman of the Research and Policy Committee, the Committee for Economic Development.

Chairman HUMPHREY. That qualifies you.

Mr. KLUTZNICK. Thank you, sir. But I have disavowed that title and role today because I want to say some things on my own out of business experience.

Now, Mr. Chairman, the first question you propounded in your invitation is: "Have bank lending practices—that is, loans to REIT's for merger activity, for condominium conversion—contributed to the length of the recession by emphasizing the scarcity of credit?"

Many banks and other lenders were unusually aggressive during the recent boom period from 1970 to 1973 and perhaps early 1974. They moved into various ventures that, at least in retrospect, seem to have carried unusually high risks and a degree of speculation. The difficulties that have been experienced with some of these loans plus related problems of the adequacy of bank capital have contributed to making the banks themselves much more cautious in their lending and investment policies. Undoubtedly, the key loan officers of some banks are concentrating on problem loans rather than on the development of new loan activity. This combination of circumstances may have contributed to the severity of the recession as well as to lending practices which may have restricted the restimulation of the economy. A more basic factor, however, has been the general restrictiveness of monetary policy and the uncertainty about the Federal Reserve's willingness to permit a vigorous expansion of lending.

This morning's papers carried another item that tends to be disconcerting to business generally because it creates doubts.

The deep involvement of the banking system, aided and abetted by Wall Street, in the unique REIT development complicated the situation. The real estate investment trust is both a new and in many ways, a good idea. When it modestly began about 15 years ago, it fulfilled a need in certain types of real estate development. It attempted to cover a limited field, cautiously, mostly during periods of relative stability.

However, when the money supply increased rapidly and banks and other investors literally shoveled resources into REIT's and interest rates simultaneously began to soar to new heights, disaster was inevitable. Equity investments, construction loans without permanent mortgage backups for all types of developments—from houses to expensive apartments, both rental and condominium, to shopping centers—as well as land speculation entered into under pressure of easily obtained credit provided a classic scenario for the literal bankruptcy of the idea itself as well as of some REIT's. Fortunately, the well-operated, careful investors in this field are still afloat and some that look bad, in my judgment, will emerge in good health one day.

The failure of REIT's to live up to repayment schedules certainly induced a degree of scarcity in credit availability, especially among banks that had been intrigued by the concept. This we must say in fairness—conversely, some of the banks' willingness to extend supportive credit to troubled REIT clients in appropriate cases probably averted further adverse chain reactions in the financial system.

Chairman HUMPHREY. May I just interrupt to say that a cartoon was brought to our attention this morning from the Forbes publication, February 1975—it says; "Federal Reserve doctor to sick companies." It is a new role for the Fed almost without precedent involving delicate discretion. But the Fed has little choice except to play it. And, of course, it shows, big companies like Chrysler, W. T. Grant Co., and so forth, all lined up trying to come into the Federal Reserve bank. I'm not being critical of that, because I happen to believe, as you have indicated that, that this gets to a point where you don't have much choice to avoid what could have been a panic, or at least a panic psychology.

Mr. KLUTZNICK. That's correct, Mr. Chairman.

The second question propounded was: "Has the Federal Reserve System been lax in monitoring either the type of loans being made by commercial banks over the past several years or the liquidity position of these banks this past year?"

Well, if any of us could run our affairs through the use of hindsight, life would be much simpler. Frequently during the studies that preceded the "Report of the Commission on Money and Credit," in 1961—the last comprehensive report of its kind—some of us on that Commission, upon which I was privileged to serve, were startled by the frequency with which Federal Reserve actions could be called "too late" or "too little" and offtimes "too early" and "too much". The decisions in the System are made by dedicated men who want to be certain that the net effect of what they do will be helpful. The economy they seek to influence at any given time is so vast and so complex that I long ago concluded that an absolutely, correctly timed and appropriate action by the Federal Reserve System would be almost a fortuitous accident. This does not diminish the importance of the function nor the slowing up or speeding up effect of some of the actions.

The record will probably show that the Federal Reserve started to tighten up its monitoring activities when the bank holding company became a common figure in our economy, for since the process of establishing such institutions encouraged a stretch in the use of bank capital. This tightening up became more severe in the wake of the United States National Bank failure in San Diego. It is not necessary to observe that the pressure was increased after the Franklin incident. But, whether or not the Federal Reserve's closer examination of practices in 1974 preceded or followed actions by the banks themselves is probably open to question in many cases. In the recent past, any conscientious banker was adequately alerted to the problems induced by novel lending practices, skyrocketing interest rates, double digit inflation, and approximately double digit unemployment.

Yet, in retrospect, it might appear that the Federal Reserve System should have been tougher in monitoring bank lending practices in the past few years—at least from 1970 until about early 1974.

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When the Fed started to push the banks hard on these matters by the spring and summer of 1974, it may actually have been somewhat too tough in light of the evolving economic situation; certainly, general monetary policy should have eased sooner.

In recent years, the Federal Reserve System has become less able to control credit through restraints on credit availability, that is, quantity, and has had to rely more and more on restraint through higher interest rates which is the equivalent of higher prices. This, in turn, has meant that to achieve a given degree of monetary restraint, interest rates have had to be pushed to successively higher levels. All this happened in part as a result of the lifting of regulation Q ceilings on interest rates on large bank certificates of deposit for short maturities in 1970 and for longer ones in 1973. This step meant that, apart from the constraints that may in time be exerted by capital adequacy considerations, banks no longer have clear limits on the volume of credit they can make available as long as funds can be purchased in the open market at successively higher interest rates and as long as they are able to pass on these higher interest costs to their customers through floating rates and other methods.

This condition would, in particular, call for an exploration of more selective credit control devices, in my judgment.

The next question was—which you have mentioned, Mr. Chairman—"Is the Federal Reserve's monetary aggregate target range—a 5-percent to 7½-percent annual rate of growth in M_1—consistent with rapid economic recovery accompanied by only modest inflation?"

I join those who do not believe in such a rigidly defined target for monetary policy. The Federal Reserve must take many factors into account in determining policy, as is required both by prudence and by the Employment Act of 1946. This basic target for both fiscal and monetary policy should be determined by the state of the economy at a given point. Nevertheless, I believe that the Federal Reserve's stated target range for fiscal year 1976 does seem to be on the low side if the aim is to achieve rapid economic growth. The Federal Reserve System should not be afraid to exceed its target if this is needed to assure the desired real growth at reasonably stable interest rates. Some have expressed the belief that with a goal of 8 percent real growth and 6 percent inflation, a money supply increase of 12 percent would be needed to keep interest rates from rising. While I would be inclined to believe that this is on the high side, certainly the upper limit of 7½ percent definitely seems to be on the low side.

In my earlier testimony before this committee on February 28, I suggested that the policy should aim at a relatively rapid rate of economic advance at the beginning stage of economic recovery and at a point when the economy is so far below its capacity. In this situation the risks of reigniting demand inflation would be minimal. Moreover, a stagnant economy would cause excessive cutbacks in capital spending and subsequent supply bottlenecks that could seriously add to cost inflation overtime.

However, the counterpart of my stress on strongly stimulative policies in the near future is my major concern that such policies do not overshoot their mark later on when the economy begins to move closer to capacity limits. Once we are near or at high employment

there will almost certainly be a need for sizable high employment Federal budget surpluses, not merely balance, if adequate funds are to be available for private capital formation. The burden of stabilizing the economy should then be shifted from excessive dependence on monetary policy, which, with a high employment surplus, could remain relatively easy.

The next question was: "Did the Federal Reserve exacerbate last winter's constrictive monetary policy by jawboning for a more-than-necessary liquidity position by banks? Was this jawboning done in response to excessively aggressive lending practices, perhaps, due to lax Federal Reserve monitoring of bank activities?"

I have already observed that the Federal Reserve may have overdone its recent jawboning to constrain bank liquidity positions. Yes this is not an easy matter to judge since individual bank situations often differ significantly. There were a number of banks, and there are now, that maintained a high degree of liquidity during this whole period. In any case, I am doubtful that this jawboning was the principal factor, apart from general monetary tightness, in the unusually cautious attitude of banks recently.

The stress on the behavior of the Federal Reserve is essential. But, somehow it should lead us to remember that its partner, fiscal policy, has not been without sin. While we have seen the dawning of a new budget procedure in the Congress which is most hopeful, we have not yet provided flexibility in handling tax rate adjustments upward and downward, which is necessary to an effective fiscal policy. In the "1961 Report of the Commission on Money and Credit" to which I have already alluded, we recommended that a minimal authority be granted to the Executive to make timely and limited tax changes in the first income tax bracket, subject to the power of the Congress by joint resolution within 30 or 60 days to veto the proposal. This recommendation was made 14 years ago. In the Committee for Economic Development, we have on a number of occasions since reinforced our belief in the necessity of a similar facility to act in the area of fiscal policy. Yet, the old procedures still prevail.

The most recent tax cut was enacted in almost record time by the Congress. Yet, it took 3½ months from the date that the President proposed it until it started to become operative. We are beginning to see its positive effect, especially in the field of consumer goods. If we had been able to make a tax cut in the lower brackets 3 or 4 months earlier, the decline might have bottomed out earlier and the recovery would have been well on its way.

Monetary policy by itself cannot effectively treat with the alternate booms and busts. All of the built-in stabilizers to which we have become accustomed since the Hoover administration are helpful. But some voices are beginning to be heard with real questions about our ability to rely on these exclusively to handle comtemporary economic situations like the ones in which we are still involved. Actually, some of them were not too effective—as our old friend Rex Tugwell pointed out recently—during simpler days until the late 1930's, when production in the defense area and later the war really brought an end to the depression. In February when I was before this committee, an appropriate question was raised as to how long we can continue to tolerate repetitive and accumulated deficits. My answer

then was that there was no better alternative presently available and that the situation seemed to be within our ability to handle. But I also stated that the Congress would have to face quite soon after the recovery the need to create a budget surplus. It does not take technical expertise to realize that there is a limit to which even our very strong and rich Nation can continue to accumulate Government debt, especially if doing so serves no purpose in stabilizing the economy. Since 1960 we have had a budget surplus—on a national income accounts basis—only three times and the years of deficit were too often years in which we should have had a surplus.

Mr. Chairman, lest I be misunderstood, I see no immediate danger to the fundamental strength of our Nation's economic position; but as I look into the future I see very little relief in prospect in terms of reduced total Government expenditures. Our people are demanding and will receive an adequate standard for the essentials of life and some of the luxuries. We are still deeply involved in costs of defense and security and there is no immediate prospect that in current dollars there will be any substantial reduction. We can only work for better control and better use of expenditures. Against this background, there is a growing number of proposals for long-range planning and for the strengthening of the Full Employment Act. You, Mr. Chairman, have introduced, together with others, a far-reaching proposal, but it is more modest than some.

I am not distressed by the notion of democratic longer term planning. I do not associate planning per se with the ownership by Government or the control by Government of the instruments of production; in fact, good planning may mean less Government intervention and control. There is danger of increased Government control, however, and in the minds of a large number of people it is a genuine danger. But, the alternatives provided by many of those who fear this danger are more of what we have been doing, which in my judgment is not enough.

The least that one could say under these circumstances is that we should not misuse our commitment to a sound monetary and fiscal policy by relying almost exclusively on monetary policy and by using fiscal policy only occasionally and then mainly in the context of tax reductions. We must commit ourselves to a greater emphasis on high employment budget surpluses in years of strong demand, not only to offset repetitive deficits but to help finance new productive capacity by retiring Government debt.

May I conclude with the suggestion that we need to address ourselves to the more general problem of the impediments to production, especially of necessities, and where this is going to take us in the years ahead in light of the awakening of price consciousness in the third world. If in fact the 1970's have brought a major change in the economic posture of our Nation, then perhaps monetary and fiscal policy will have to be supplemented by a better forward and longer look at a third element, namely the production process. I need not utter the obvious—wealth flows from production. It is perhaps long past due for a congressional examination of the structural impediments to increased production at stable prices. The Committee for Economic Development has said this in the past as well, and perhaps,

instead of an economic duet of fiscal and monetary policy for stability, we need a trio which includes increased production at stable prices as well as sound fiscal monetary policies.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Klutznick follows:]

PREPARED STATEMENT OF PHILIP M. KLUTZNICK

Mr. Chairman, Members of the Committee, and fellow panelists: My name is Philip M. Klutznick. I am pleased to return for an appearance before your Committee to examine some aspects of the perennial problem of credit availability. As a businessman who has served on bank boards and operated in other businesses as well as real estate development companies, I am full of sympathy for your effort to find answers to the questions that were propounded in your invitation.

I am inhibited to a degree by my responsibility as Chairman of the Research and Policy Committee of the Committee for Economic Development. There are some aspects of my testimony that have not been the subject of policy statements by CED, and therefore, I prefer to testify as an individual, calling on such experience as I may have had, and to avoid attribution to that worthy organization, the CED, with which I am proud to be associated. In view of your request that the opening statements be limited, I shall leave it to your later examination to clarify some of the statements that I will make which are of necessity brief.

Mr. Chairman, the first question you propounded in your invitation is: "Have bank lending practices (e.g. loans to REIT's for merger activity, for condominium conversions) contributed to the length of the recession by emphasizing the scarcity of credit?"

Many banks and other lenders were unusually aggressive during the recent boom period from 1970 to 1973 and perhaps early 1974. They moved into various ventures that, at least in retrospect, seem to have carried unusually high risks and a degree of speculation. The difficulties that have been experienced with some of these loans plus related problems of the adequacy of bank capital have contributed to making the banks themselves much more cautious in their lending and investment policies. Undoubtedly, the key loan officers of some banks are concentrating on problem loans rather than on the development of new loan activity. This combination of circumstances may have contributed to the severity of the recession as well as to lending practices which may have restricted the re-stimulation of the economy. A more basic factor, however, has been the general restrictiveness of monetary policy and the uncertainty about the Federal Reserve's willingness to permit a vigorous expansion of lending.

The deep involvement of the banking system, aided and abetted by Wall Street, in the unique REIT development complicated the situation. The real estate investment trust is both a new, and in many ways, a good idea. When it modestly began about fifteen years ago, it fulfilled a need in real estate development. It attempted to cover a limited field cautiously, mostly during periods of relative stability. However, when the money supply increased rapidly and banks and other investors literally shovelled resources into REIT's and interest rates simultaneously began to soar to new heights, disaster was inevitable. Equity investments, construction loans without permanent mortgage backups for all types of developments—from houses to expensive apartments, (both rental and condominium) to shopping centers—as well as land speculation entered into under pressure of easily obtained credit provided a classic scenario for the literal, bankruptcy of the idea itself as well as of some REIT's. The well operated careful investors in this field are still afloat and some that look bad will emerge in good health one day. However, the debacle will leave a large question about the credibility of the whole idea in the minds of the investing public. This is regrettable.

The failure of REIT's to live up to repayment schedules certainly induced a degree of scarcity in credit availability, especially among banks that had been intrigued by the concept. But, conversely, some of the banks' willingness to extend supportive credit to troubled REIT clients in appropriate cases probably averted further adverse chain reactions in the financial system.

The second question propounded was: "Has the Federal Reserve System been lax in monitoring either the type of loans being made by commercial banks over the past several years or the liquidity position of these banks this past year?"

If any of us could run our affairs through the use of hindsight, life would be much simpler. Frequently during the studies that preceded the Report of the Com-

mission on Money and Credit in 1961—the last comprehensive report of its kind—some of us on the Commission were startled by the frequency with which Federal Reserve actions could be called "too late" or "too little" and ofttimes "too early" and "too much." The decisions in the System are made by dedicated men who want to be certain that the net effect of what they do will be helpful. The economy they seek to influence at any given time is so vast and so complex that I long ago concluded that an absolutely correctly timed and appropriate action by the Federal Reserve System would be almost a fortuitous accident. This does not diminish the importance of the function nor the slowing up or speeding up effect of some of the actions.

The record will probably show that the Federal Reserve started to tighten up its monitoring activities when the bank holding company became a common figure in our economy since the process of establishing such institutions encouraged a stretch in the use of bank capital. This tightening up became more severe in the wake of the United States National Bank failure in San Diego. It is not necessary to observe that the pressure was increased after the Franklin incident. But, whether or not the Federal Reserve's closer examination of practices in 1974 preceded or followed actions by the banks themselves is probably open to question in many cases. In the recent past any conscientious banker was adequately alerted to the problems induced by novel lending practices, skyrocketing interest rates, double digit inflation and approximately double digit unemployment.

Yet, in retrospect it might appear that the Federal Reserve System should have been tougher in monitoring bank lending practices in the past few years—at least from 1970 until about early 1974. Again said judgments are always made easier by hindsight. Many loans began to appear to be of poor quality; once money got very tight, interest rates skyrocketed, the illusions created by inflation were more clearly understood and the onset of a severe recession became evident. By mid-1974 the Federal Reserve called for tighter standards and a "go slow" policy in lending. Like overall tight money policy, the efforts to tighten up standards may actually have been a case of "too much, too late" since they came at a time when economic activity was contracting sharply.

The Federal Reserve probably did not put enough stress on problems of bank liquidity and capital adequacy during the earlier stages of the 1970–1973 boom. When it started to push the banks hard on these matters by the spring and summer of 1974, it may actually have been somewhat too tough in light of the evolving economic situation; certainly, general monetary policy should have eased sooner.

In recent years, the Federal Reserve System has become less able to control credit through restraints on credit availability, that is, quantity, and has had to rely more and more on restraint through higher interest rates which is the equivalent of higher prices. This, in turn, has meant that to achieve a given degree of monetary restraint, interest rates have had to be pushed to successively higher levels. All this happened in part as a result of the lifting of Regulation Q ceilings on interest rates on large bank certificates of deposit for short maturities in 1970 and for longer ones in 1973. This step meant that, apart from the constraints that may in time be exerted by capital adequacy considerations, banks no longer have clear limits on the volume of credit they can make available as long as funds can be purchased in the open market at successively higher interest rates and as long as they are able to pass on these higher interest costs to their customers through floating rates and other methods. This general tendency probably emphasizes the need for alternative techniques to enable the system to exert more influence on credit availability and to avoid an excessive upward ratcheting in interest rates. This would, in particular, call for an exploration of more selective credit control devices.

In connection with the President's Economic Summit, I submitted a brief statement in which I frankly expressed the view that the notion that we did not have credit allocation in our economic system except through appropriate market forces was misleading to us. What is more, it was in very ways a contributing factor to inflation and to a misdirection of production facilities. Since the abnormally high interest rates could only be tolerated by producers or borrowers who could pass them on to the consuming public, the cost of money became as much an inflationary pressure as even non-productive wage increases, and perhaps was even more inflationary. It also effectively eliminated from the market highly desirable and necessary economic and social programs such as housing which could not compete in the market place for money since they could not pass the added cost on to the consumer. So long as interest rate adjustments were nominal and the time period was relatively short, such adverse impacts on our economy

could be absorbed without extraordinary damage. However, when the rates reached new highs regularly and continued over a long period, the impact on our economic and social structure became readily demonstrable. So, we have had credit allocation by default and it has actually been a disservice to our national objectives.

The next question was: "Is the Federal Reserve's monetary aggregate target range (a 5 percent to a 7½ percent annual rate of growth in M_1) consistent with rapid economic recovery accompanied by only modest inflation?"

I join those who do not believe in such a rigidly defined target for monetary policy. The Federal Reserve must take many factors into account in determining policy, as is repuired both by prudence and by the Employment Act of 1946, and Congress should do the same. The basic target for both fiscal and monetary policy should be determined by the state of the ceonomy at a given point. Nevertheless, I believe that the Federal Reserve's stated target range for fiscal year 1976 does seem to be on the low side if the aim is to achieve rapid economic growth. The Federal Reserve System should not be afraid to exceed its target if this is needed to assure the desired real growth at reasonably stable interest rates. Some have expressed the belief that with a goal of 8 percent real growth and 6 percent inflation, a money supply increase of 12 percent would be needed to keep interest rates from rising. While I would be inclined to believe that this is on the high side, certainly the upper limit of 7½ percent definitely seems to be on the low side.

In my earlier testimony before this Committee on February 28, I suggested that the policy should aim at a relatively rapid rate of economic advance at the beginning stage of economic recovery and at a point when the economy is so far below its capacity. In this situation the risks of reigniting demand inflation would be minimal. Moreover, a stagnant economy would cause excessive cutbacks in capital spending and subsequent supply bottlenecks that could seriously add to the cost inflation over time.

However, the counterpart of my stress on strongly stimulative policies in the near future is my major concern that such policies do not overshoot their mark later on when the economy begins to move closer to capacity limits. Once we are near or at high employment there will almost certainly be a need for sizable high employment Federal budget surpluses, not merely balance, if adequate funds are to be available for private capital formation. The burden of stabilizing the economy should then be shifted from excessive dependence on monetary policy, which, with a high employment surplus, could remain relatively easy.

The next question was: "Did the Federal Reserve exacerbate last winter's constrictive monetary policy by jawboning for a more-than-necessary liquidity position by banks? Was this jawboning done in response to excessively aggressive lending practices, perhaps, due to lax Federal Reserve monitoring of bank activities?"

I have already observed that the Federal Reserve may have overdone its recent jawboning to constrain bank liquidity positions. This is not an easy matter to judge since individual bank situations often differ significantly. To my knowledge there were a number of banks that maintained a high degree of liquidity during this whole period. In any case, I am doubtful that this jawboning was the principal factor, apart from general monetary tightness, in the unusually cautious attitude of banks recently. As I have previously stated, the shock effect of widely publicized and unusually large bank failures and of other credit quality and liquidity problems has had a pronounced effect and has perhaps been of greater importance in causing the management of banks to "run scared."

The stress on the behavior of the Federal Reserve is essential. But somehow it should lead us to remember that its partner, fiscal policy, has not been without sin. While we have seen the dawning of a new budget procedure in the Congress which is most hopeful, we have not yet provided flexibility in handling tax rate adjustments upward and downward, which is necessary to an effective fiscal policy. In the 1961 Report of the Commission on Money and Credit to which I have already alluded, we recommended that a minimal authority be granted to the Executive to make timely and limited tax changes in the first income tax bracket, subject to the power of the Congress by joint resolution within thirty or sixty days to veto the proposal. This recommendation was made fourteen years ago. In the Committee for Economic Development, we have on a number of occasions since reinforced our belief in the necessity of a similar facility to act in the area of fiscal policy..

The fact that these proposals have not been adopted can undoubtedly be largely explained by reluctance on the part of the Congress to grant the Executive significant added discretion in the area of tax policy. That is why in my testimony

before this Committee last February, I made a personal suggestion for a procedure that would permit speedier tax adjustments but leave the principal responsibility with the Congress. Specifically, I suggested that the Congress should consider enactment of a contingency tax cut which could be promptly activated at a later date if unemployment rates exceeded specified levels or, preferably, upon passage of a joint Congressional resolution affirming the need for such a cut. The same procedure could, of course, also be used with respect to tax increases. I continue to believe that the effectiveness of fiscal policy would be greatly improved if a procedure of this type were adopted.

The most recent tax cut was enacted in almost record time by the Congress. Yet, it took three and a half months from the date that the President proposed it until it started to become operative. We are beginning to see its positive effect, especially in the field of consumer goods. If we had been able to make a tax cut in the lower brackets three our four months earlier, the decline might have bottomed out earlier and the recovery would have been well on its way.

Monetary policy by itself cannot effectively treat with the alternate booms and busts. All of the built-in stabilizers to which we have become accustomed since the Hoover Administration are helpful. But some voices are beginning to be heard with real questions about our ability to rely on these exclusively to handle economic situations like the ones in which we are still involved. Actually, some of them were not too effective during simpler days until the late 30s when production in the defense area and later the war really brought an end to the depression. In February when I was before this Committee, an appropriate question was raised as to how long we can continue to tolerate repetitive and accumulated deficits. My answer then was that there was no better alternative presently available and that the situation seemed to be within our ability to handle. But I also stated that the Congress would have to face quite soon after the recovery the need to create a budget surplus. It does not take technical expertise to realize that there is a limit to which even our very strong and rich nation can continue to accumulate government debt, especially if doing so serves no purpose in stabilizing the economy. Since 1960 we have had a budget surplus (on a national income accounts basis) only three times and the years of deficit were too often years in which we should have had a surplus. While government debt can be repaid with cheaper dollars, in view of our international involvement and the impact on our economy by increased prices of essentials, such as energy and primary products, the question of how long we can continue to devalue the dollar is also pertinent.

Lest I be misunderstood, I see no immediate danger to the fundamental strength of our nation's economic position; but as I look into the future I see very little relief in prospect in terms of reduced total government expenditures. Our people are demanding and will receive an adequate standard for the essentials of life and some of the luxuries; we are still deeply involved in costs of defense and security and there is no immediate prospect that in current dollars there will be any substantial reduction. We can only work for better control and better use of expenditures. Against this background, there is a growing number of proposals for long-range planning and for the strengthening of the Full Employment Act. You, Mr. Chairman, have introduced together with others a far-reaching proposal, but it is more modest than some.

I am one of those who is not distressed by the notion of democratic longer term planning. I do not associate planning per se with the ownership by government or the control by government of the instruments of production; in fact, good planning may mean less government intervention and control. There is danger of increased government control, however, and in the minds of a large number of people it is a genuine danger. But, the alternatives provided by those who fear this danger are more of what we have been doing.

The least that one could say under these circumstances is that we should not misuse our commitment to a sound monetary and fiscal policy by relying almost exclusively on monetary policy and by using fiscal policy only occasionally and then mainly in the context of tax reductions. We must commit ourselves to a greater emphasis on high employment budget surpluses in years of strong demand, not only to offset repetitive deficits but to help finance new productive capacity by retiring government debt.

I would also suggest that we need to address ourselves to the more general problem of the impediments to production, especially of necessities, and where this is going to take us in the years ahead in light of the awakening of price consciousness in the third world. If in fact the 70s have brought a major change in the economic posture of our nation, then perhaps monetary and fiscal policy will have to

be supplemented by a better forward and longer look at a third element, namely the production process. I need not utter the obvious—wealth flows from production. It is perhaps long past due for a Congressional examination of the structural impediments to increased production at stable prices. The Committee for Economic Development has said this in the past as well. And perhaps, instead of an economic duet of fiscal and monetary policy for stability, we need a trio which includes increased production at stable prices as well as sound fiscal and monetary policies.

Chairman HUMPHREY. Thank you very much, Mr. Klutznick.

You will be interested to know that the committee is now working on a projected scenario to examine the Employment Act of 1946 and its deficiencies, as well as its contributions to our economy. That act of course calls for policies to be authorized and then pursued, which promote maximum production, income, and maximum employment. And we are going to examine the structural matters that you have noted here.

I think that is at the heart, really, if I may say, of our problem. And we need to get at it. It is a monumental task. We are going to have to call upon a lot of people on the outside of the Congress to help us with it. But we hope we can make a contribution.

Mr. Thurow, please.

Mr. THUROW. Thank you, Mr. Chairman.

STATEMENT OF LESTER C. THUROW, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. THUROW. To understand the current recession, it is important to understand that it is not a product of unfortunate accidents or unavoidable external events such as the Arab oil boycott. The blame should be squarely, and about equally, placed on poor monetary and fiscal policies. The last quarter with a positive real rate of growth was the fourth quarter of 1973. Whatever you believe about the ability or inability of economists to forecast the future of GNP, it is clearly inappropriate to be depressing the economy after the GNP has already begun to fall. Yet that is exactly what this administration's economic planners did.

According to the calculations of the President's economic report the full employment surplus of Federal, State and local governments rose from $17 billion in the fourth quarter of 1973 to $46 billion in the third quarter of 1974. By the first quarter of 1975, the full employment surplus had reached $61 billion.

At the same time, interest rates—short-term business loans—were rising from 10.1 percent in the fourth quarter of 1973 to 12.4 percent in the third quarter of 1974. Given substantial amounts of credit rationing equilibrium interest rates were even higher than these figures would indicate. Behind this shift in interest rates was a money supply—M_1—that declined from an 8.8-percent rate of growth in the fourth quarter of 1973 to 1.6 percent in the third quarter of 1974.

With stringent fiscal and monetary policies of this magnitude in effect, it is hardly surprising that the economy's negative rate of growth accelerated sharply in the fourth quarter of 1974 and the first quarter of 1975. The economy collapsed for a very simple reason: Monetary policies were put in place to make it collapse.

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The tight fiscal and monetary policies of 1974 and the inadequate fiscal and monetary policies of 1975 are both justified in terms of fighting inflation. To correct fiscal and monetary policies it is important to understand why this argument was wrong in 1974 and is wrong in 1975.

The 1973–74 burst of inflation was a supply-push inflation rather than a demand-pull inflation. In the fourth quarter of 1973, when economic growth stopped, the unemployment rate was near 5 percent and 17 percent of manufacturing capacity was unutilized. Seven percent of capacity was idle in major raw materials industries. Demand-pull inflation occurs when the demand for goods and services exceeds the capacity of the economy to produce goods and services. It can and should be eliminated by depressing the economy, but unfortunately, the inflation of 1973–74 was not a demand-pull inflation and could not be eliminated by cutting demands for goods and services with tight fiscal and monetary policies.

The 1973–74 inflation sprang out of supply induced shortages of agriculture products, the embargo and price increase on imported oil, and a few raw materials. If you examine these problems—and we may have them again in September of this year—it is clear that depressing the economy can have little effect. Imported oil is not being priced in a supply and demand market where cutbacks in demand lead to price decreases. The current recession will not stop oil price increases from being put into effect this fall. When this occurs, the rate of inflation will once again accelerate regardless of what happens to the domestic economy. Given essentially zero income elasticities of demand for food products, cutting incomes can have no effect on food prices. Reducing demand may help lower prices for a few industrial raw materials but this is a temporary phenomenon that disappears whenever the economy returns to full employment, if it ever does.

As a result we are not in a world where there is a cruel tradeoff between more unemployment and more inflation. At the moment, the two are basically unrelated to each other. Not stimulating the economy will not improve the inflation picture; stimulating the economy will not worsen the inflation picture. Stimulating the economy will do only one thing—it will reduce unemployment—something that is to be highly desired when almost 1 out of every 10 workers is without work. And I remind you that unemployment has yet to peak.

Our economy needs both more fiscal and monetary stimulus if it is to return to lower unemployment rates. Given the administration's current economic forecasts, unemployment will have fallen by less than one percentage point from our, as yet, unreached peak by the end of 1976. Given the economic burdens that this imposes on millions of families, such forecast and policies should be regarded as unacceptable.

While tight monetary policies have a retarding effect on the total economy, they also impose uneven burdens on different sectors of the economy. Even if restrictive policies are necessary, there is still a problem of fairly sharing the necessary losses. Given the actual gains and losses during 1974, it is hard to argue that the burdens of slowing the economy were equitably shared. And I call your attention to table 1, which shows the flow of funds across the economy during the credit crunch of 1974.

[The table follows:]

TABLE 1.—FUNDS RAISED AND ADVANCED IN U.S. CREDIT MARKETS

	1973 (billions of dollars)	Percent increase 1st half 1974	(+) or decrease (−) 2d half 1974
Debt capital instruments	97.1	+3.9	−15.9
State and local	13.7	+29.9	−9.6
Corporate and foreign	10.2	+98.0	+7.4
Mortgages	73.2	−14.1	−25.0
Home	43.3	−17.3	−24.9
Other residential	8.4	−13.1	+5.4
Commercial	17.0	−7.6	−55.4
Farm	4.4	−7.8	+34.1
Other private credit	73.4	+6.5	−29.9
Bank loans n.e.c	38.6	+2.6	−58.0
Consumer credit	22.9	−44.5	−48.0
Open market paper	1.8	+755.6	−6.5
Other	10.0	−19.0	+84.7
By borrowing sector total debt instruments	170.4	+5.2	−22.0
Foreign	7.7	+160.0	−43.8
State and local	12.3	+30.1	−1.9
Households	72.8	−65.2	−20.8
Nonfinancial business	77.6	+23.2	−21.4
Farm	8.6	−15.1	+2.8
Nonfarm noncorporate	9.3	−22.6	−12.5
Corporate	59.7	+36.0	−24.4

Mr. THUROW. From 1973 to the first half of 1974, total funds advanced in the U.S. credit markets rose 5.2 percent, but corporate debt instruments rose 36 percent and foreign debt instruments rose 61 percent while total household debt instruments fell 65 percent, farm debt instruments fell 15 percent, and nonfarm noncorporate debt instruments fell 23 percent.

Chairman HUMPHREY. Just what does corporation debt instrument mean?

Mr. THUROW. What it basically means, Senator, is that during the first half of 1974 when the credit crunch was starting, although total funds available to be lent were going up slowly, corporate lending was going up very rapidly, and foreign lending was going up very rapidly, but household lending, farm lending and noncorporate, nonfarm lending was going down very rapidly.

Chairman HUMPHREY. What you are pointing out is that there was a kind of allocation of credit.

Mr. THUROW. We were starting to see a very uneven effect of the credit crunch even before it got going.

In the initial phases of the 1974 monetary crunch preferred sectors were still obtaining substantial funds while the less preferred sectors had already begun to experience sharp cutbacks in flows of funds.

In the second half of 1974 total debt instruments fell 22 percent and the credit squeeze reached the corporate sector as well as the less preferred sectors. Corporate instruments were down 24 percent, but their total decline over the course of the year was much less than that for other sectors.

The uneven impact of monetary policies is aggravated by the uneven impact of a recession on the ability to generate saving internally. Personal savings fell 3.1 percent while corporate savings was rising 8.8 percent from the fourth quarter of 1973 to the fourth quarter of 1974. Thus monetary policies and the recession reinforced each other by cutting investment funds for exactly the same groups.

If further divisions could be made between large and small business and between high and middle income borrowers, we would undoubtedly find that monetary policies had an even more concentrated effect than our data now indicate. Any user of stringent monetary policies must take into account the uneven impact of monetary policies as well as their total effect. Congress needs to play a role in changing financial institutions, so that, when we in the future, use monetary policies to restrict the economy, will have a rather even impact across the economy rather than hitting a few sectors very hard.

Given the occasional need to carry out restrictive fiscal and monetary policies—even if they were not necessary in this case—some way must be found to spread the losses more equally across the population. The problem of fairly shared losses rather than gains is an uncomfortable one, but it is a crucial one nonetheless.

Since early 1975, monetary policies have eased relative to the demands of the economy. Much of the ease had occurred, however, due to a decline in the demand for funds induced by the recession rather than a significant easing of monetary policies. Over the 4 months from December 1974 to April 1975, the money supply grew by only 1.3 percent. At an annual rate it was 3.9 percent.

Monetary policies are not contributing to economic growth and if rapid economic growth should start, it would be choked off by restrictive monetary policies. If you think of the kind of monetary ease that would be necessary to lower employment significantly over the next 2 years, it is clear that monetary growth of this magnitude is inadequate. Our economy is going to face recessionary unemployment rates for as far as anyone can see into the future.

Thank you.

Chairman HUMPHREY. When you say that you mean under present monetary policy projections?

Mr. THUROW. Under present projections, as you well know, the President's own advisers have predicted recessionary unemployment rates up through 1980.

Chairman HUMPHREY. Yes.

And I might add they have repeated that time after time, with apparently little feeling that anything is wrong, so it is just sort of like, "Well, this is the way it is, you have short legs and you get used to short legs."

Mr. THUROW. I think the important thing is to realize that the role for fighting inflation at the moment is not a matter of restrictive fiscal and monetary policies. If you want to fight inflation you are going to off and fight the Arabs or something, but not impose tight monetary and tight fiscal policies.

Chairman HUMPHREY. Thank you very much.

Mr. Dubois, I welcome you. But as I said earlier, I want to thank you very much for the survey you are going to provide our committee and for your helpful testimony over the years. Please proceed.

STATEMENT OF PAT DuBOIS, CHAIRMAN, FEDERAL LEGISLATIVE COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. DUBOIS. Mr. Chairman and members of the Joint Economic Committee, I am Pat DuBois, president of the First State Bank,

Sauk Centre, Minn., and chairman of the Federal Legislative Committee of the Independent Bankers Association of America.

I have with me Kenneth J. Benda, president of our association and president of the Hartwick State Bank in Hartwick, Iowa; Don Kirchner, chairman of our association's Agriculture-Rural America Committee and president of the People's Trust and Savings Bank of Riverside, Iowa, and really our agricultural expert; Lewis Markus of Washington, D.C., an economist retained by our association; Howard Bell, the executive director; Glenn Swanson, who manages our Washington office; and Richard Peterson, a lawyer and lobbysit for the association whom many of you know.

It is my pleasure to appear today, Mr. Chairman, in response to the chairman's invitation to present the views of IBAA with respect to (*a*) the adequacy of the flow of credit to the agriculture and to rural America, and the extent to which rural bankers are meeting the credit needs of farmers; (*b*) alternative institutional arrangements which might be made to facilitate credit flows to agriculture; and (*c*) what steps Congress should take to insure the competitive viability of the Nation's independent banks.

The Independent Bankers Association of America represents 7,300 banks with assets aggregating $135 billion or 15 percent of the assets of all insured commercial banks in the United States. Approximately 80 percent of our member banks have assets under $25 million. More than 70 percent of our membership is located in the 18 major agricultural States and in the rural communities of these States. We are, therefore, deeply concerned with the problems of the farmer and rural America and we appreciate the opportunity to present our views to this distinguished committee. I have submitted a full statement for the record. These remarks will be a summary of that statement.

I. ADEQUACY OF THE SUPPLY OF AGRICULTURAL CREDIT

A. *Agricultural credit trends.*—The steady growth of agricultural credit in the last decade indicates that over the long term the demand is being met by commercial and Government-supported sources of credit. In the period 1965–74 total outstanding farm debt rose by record amounts, and the boom in farm debt is expected to continue into 1975. Both real estate and non-real-estate farm debt have registered strong advances.

A recent surge in farm borrowing reflects shifts in a number of factors which affect both the demand for, and the supply of, loan funds. Lenders were motivated to provide a larger volume of loan funds to farmers by more competitive yields and lower risks on farm loans, and strong deposit inflows. Farm borrowing, on the other hand, has expanded to accommodate the shift toward all out production, larger capital investment and operating inputs, and the rising cost of virtually all farm inputs.

Institutional lenders have been the major source of credit in meeting the booming demand for farm loans. In the farm mortgage market, commercial banks and Federal Land Banks have made the most significant contributions, although the bulk of farm real estate debt is held by individuals and others.

In regard to non-real-estate credit, commercial banks, individuals and merchant dealers are the largest source, although merchant dealers

have recently curtailed such credit due to high costs of borrowed money and a seller's market caused by short supplies of feeds, fertilizers, petroleum products, and farm machinery.

B. *Developments in Agricultural Credit, 1974–1975.*—That the credit needs of agriculture are currently being met is indicated by the growth of real estate and non-real-estate debt in 1974 and in the early months of 1975. Outstanding farm real estate debt increased 15 percent and non-real-estate debt 9 percent in 1974. These increases were achieved despite an appreciable tightening of funds for lending at rural banks due to a slowing in deposit growth and an expanding loan volume which raised loan-to-deposit ratios among rural banks.

While the issue of the adequacy of financing to maintain agricultural operations has been widely debated in recent months, most bankers feel that farmers will receive adequate credit.

C. *Adequacy of agricultural credit in 1975 as viewed by IBAA members.*—A canvass of a random sample of IBAA members in rural areas was undertaken last month to provide this committee with a current grass roots views of the agricultural credit situation. Generally, the survey revealed that our member banks were meeting the credit needs of their farm customers.

Most of the survey respondents reported increased operating loans and farm machinery loans. On the other hand, a majority experienced a decline in the volume of livestock loans. No change in the volume of crop storage loans and dairy operation loans was indicated by those reporting.

About half of the banks responding to our inquiry received loan applications from acceptable farm borrowers that exceeded their loan limits. In most cases these banks obtained correspondent bank participation to overcome the overline limits.

Looking ahead, 97 percent of the responding rural banks were optimistic as to their ability to meet future increases in the credit needs of the farmers in their area. When questioned as to how they would meet the anticipated growth of credit demand, most expected to rely on the growth of deposits, capital, and surplus.

One of the most significant revelations of our survey was the inability of rural banks to make effective use of the loan program of the Rural Development Act of 1972. One of the principal reasons given for the failure of our banks to participate in the RDA program was lack of familiarity with the program and excessive paperwork, which suggests failure on the part of the Government to implement the program.

Chairman HUMPHREY. Do you think that the FHA officers there were ill-equipped to handle this part of the program?

Mr. DUBOIS. I think at the onset they were ill-equipped. I think that the expertise was available to them, but I feel very strongly that it was not their desire to implement the act as intended by Congress.

Chairman HUMPHREY. Have you seen any improvement in that of late?

Mr. DUBOIS. Very little.

Chairman HUMPHREY. We have that sort of information come to the committee some time ago on monitoring the rural development program.

D. *Impact of a bumper crop on loan repayment schedules and farm debt.*—Historically agriculture has experienced a series of crises since the 1930's and there are some who are fearful that another crisis is approaching.

Farmers are somewhat protected by land values, which continued to rise despite the recession and falling crop prices. But it appears that the land-value boom of 1973 has ended and demand for farm land has begun to slacken. Many farmers are securing funds to pay off old debts as well as to finance current crops by mortgaging land and equipment, much of which had been paid off after the high-profit years of 1973 and 1974. However, mortgaging land to provide cash is tantamount to selling assets to stay afloat and may be delaying rather than avoiding a crisis.

A big harvest this year may signal the end of the farm boom and there is talk of an agricultural recession and a farm price bust. Last year, realized net income fell 16 percent to $27.2 billion. Falling commodity prices along with still rising production expenses may depress net income to about $20 billion this year. The Agriculture Department, while admitting that the price-cost squeeze is pinching harder, does not anticipate a real old fashioned agriculture depression.

The Department of Agriculture last December projected substantial carryovers of 1975 crops of corn and soybeans which may necessitate liberalization of the Government's crop-loan program despite Agriculture Secretary Butz's policies designed to reduce the Government's role in agriculture.

E. *Adequacy of credit for rural development.*—While the credit needs of agriculture are being met, there is a clear and present need to increase the supply of funds for community development in rural America. The Rural Development Act of 1972 thus far has produced minimal results.

Probably the most important rural assistance measures could be the business and industrial and the community facilities loan programs passed by Congress which have not been implemented by the Farmers Home Administration. These programs have been funded at only a modest level and their impact has been small.

Every time rural development comes up for funding, the administration has consistently refused to request the funding despite the intent of the Congress to make the act a vehicle to channel the tax dollars of rural America back to their communities.

In testimony before the Subcommittee on Rural Development of the Senate Committee on Agriculture and Forestry in May 1974, I pointed out IBAA's concern with respect to the delay in implementing the Rural Development Act; the lack of a suitable secondary market for Farmers Home Administration guaranteed loans; and the inadequate loan limits for farm ownership and operating loans. IBAA has strongly supported the objectives of the act and has urged its member banks to participate in its implementation. A survey of IBAA member banks in 1974 revealed the membership's continuing desire for and willingness to assist in making the act achieve its purposes. However, there is little that rural bankers can do to assist in achieving the objectives of the Rural Development Act so long as Government funding continues to be inadequate and the Farmers Home Administration fails to carry out the purposes and objectives of the act.

In addition, rural bankers have been hampered in making loans under the Rural Development Act by the lack of clear rules and procedures to be followed under the statute.

II.

The role of rural bankers in meeting the credit needs of agriculture and alternative institutional arrangements which might facilitate credit flows to agriculture:

Rural banks are often the principal suppliers of credit used by farmers and small businesses and these borrowers prefer to rely on private financial institutions rather than Federal credit programs to meet their credit needs. This view rests on the proposition that the private sector can usually deal more effectively with the novel credit demands or those that are unique to certain regions or require some departure from traditional financing methods.

A rough measure that the role that commercial banks now play in rural areas is the loan-deposit ratio of rural banks. Generally, rural banks throughout the United States have a smaller percentage of their deposits loaned out than urban banks and a larger percent invested.

Because rural banks are affected by the seasonal credit demands of agriculture and tourism they acquire short-term assets during periods when seasonal pressures are low and dispose of them as seasonal needs expand. The seasonal influence adversely affects a bank's ability to lend.

In 1973 the Federal Reserve System amended regulation A to provide eligible member banks a seasonal borrowing privilege which permits them to obtain funds from their Federal Reserve banks on a temporary basis to meet seasonal credit requirements. To make the privilege more effective legislation proposed by the Board of Governors of the Fed in 1974 to extend the privilege to all nonmember banks should be enacted by the Congress.

In 1970 the Board of Governors of the Federal Reserve System established a study committee to continue investigation of rural banking problems that had been pointed out in the "Report of a System Committee" as part of the "Reappraisal of the Federal Reserve Mechanism." The central cause of these problems, as described in that report, is the inability of small banks—as sellers of assets or liabilities—to raise funds effectively in the Nation's financial markets. We urge the Federal Reserve Board to give serious consideration to the recommendations of the study committee and to take prompt action toward their implementation.

There are, however, observers who advocate structural changes in the present banking system to better equip rural banking to serve the credit needs of modern large-scale farm and business enterprises.

We, as advocates of unit banking, contend that: (1) Branching and similar structural changes disrupt the close identification of rural bankers with their market; (2) While rural bankers may serve a small market area they can diversify their portfolios through participations with correspondent banks; (3) There is no evidence that small branch banks in rural areas would be able to pull funds from larger urban banks in the system to make loans to rural enterprise; (4) Branching does not transfer more money into rural areas but instead enables deposits collected from rural areas to be more easily shifted to urban

areas where credit demand and interest rates are higher; and (5) Claims that small unit banks tend to nonopolize their communities are not justified since rural business people are mobile and can seek the services of banks in neighboring areas when dissatisfied with their hometown banks.

III.

Recommendations for action to insure the competitive viability of the Nation's independent banks:

One of the major concerns of independent banks is the growth of concentration of commercial banking and the steady erosion of the independent banking sector attributable to the growth of multibank holding companies. Congress should, therefore, intitate a comprehensive examination of (*a*) the present structure of commercial banking and the effects on competition of the growth of bank holding companies through the acquisition of independent banks; (*b*) the effects on competition resulting from the proliferation of bank-related fields which bank holding companies have been permitted to enter since the 1970 amendment to the Bank Hold Company Act; (*c*) the adequacy of the antitrust laws to deal with bank holding company acquisitions of independent banks which may lessen actual or potential competition, in view of the limitations imposed on the antitrust enforcement agencies by recent decisions of the Supreme Court in *U.S.* v. *Marine Bancorporation, Inc., et al.;* and (*d*) the feasibility of granting stockholders of independent banks relief from the capital gains tax in order to foster the transfer of ownership of independent banks to interests other than multibank holding companies by making a sale to an independent entity as attractive, tax-wise, as a sale to a multibank holding company.

The Federal Reserve Board should implement the following recommendations of the Committee on Rural Banking Problems; (*a*) improve the access of member and nonmember small banks to the principal money markets by acting as broker for the sale of agricultural loans in the open market; (*b*) establish a mechanism for assembling and pooling of special time deposit certificates from small banks and periodlcally conducting an auction of large-denomination participations in the pool of these certificates; and (*c*) work out arrangements whereby correspondent banks would receive payment of services provided to small banks, on a reasonable fee basis, rather than by requiring the maintenance of compensating balances in order to expand the supply of loanable funds available to small banks.

The Congress should enact legislation which would extend to nonmember banks the seasonal borrowing privilege presently available, through the Federal Reserve banks' discount mechanism, only to member banks.

The Congress should investigate the lack of effective implementation of the Rural Development Act by the Farmers Home Administration to determine how to make the act and its implementation effective in achieving its objectives and the adequacy of the funds appropriated to fund the act's various programs.

The Congress should act favorably upon the request of the Federal Reserve Board for authority to deal with the problem of protecting subsidiary banks from the misfortunes of holding company affiliates

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or improper transactions with them since there is no authority in any Federal agency to supervise such practices by bank holding companies.

The Congress should initiate an inquiry, as early as possible, into the delay in the appointment of the National Commission on Electronic Fund Transfers authorized by a law enacted in October 1974 since delay in the appointment of the commission has already resulted in the introduction of full-scale EFT systems without adequate experimentation which could have detrimental permanent effects on the competitive structure of the Nation's financial institutions.

And finally, we urge the House Banking, Currency and Urban Affairs Committee to include in its ongoing FINE study, a thorough examination of the role small rural banks play in meeting the credit needs of the Nation's farmers and rural communities, in order to determine how best to expand the supply of loanable funds available to these banks. It is essential in meeting the growing demands for agricultural credit.

[The prepared statement of Mr. DuBois follows:]

Prepared Statement of Pat DuBois

Mr. Chairman and Members of the Joint Economic Committee, I am Pat DuBois, President of the First State Bank, Sauk Centre, Minnesota, and Chairman of the Federal Legislative Committee of the Independent Bankers Association of America. I appear in response to the Chairman's invitation to present the views of IBAA with respect to (a) the adequacy of the flow of credit to agriculture and to rural America, and the extent to which rural bankers are meeting the credit needs of farmers; (b) alternative institutional arrangements which might be made to facilitate credit flows to agriculture; and (c) what steps Congress could take to insure the competitive viability of the nation's independent banks.

The Independent Bankers Association of America represents 7,300 banks with assets aggregating $135 billion or 15 percent of the assets of all insured commercial banks in the United States. Approximately 80 percent of our member banks have assets under $25 million. More than 70 percent of our membership is located in the 18 major agricultural states and in the rural communities of these states. We are, therefore, deeply concerned with the problems of the farmer and rural America and we appreciate the opportunity to present our views to this distinguished committee.

I. Adequacy of the Supply of Agricultural Credit

A. AGRICULTURAL CREDIT TRENDS

The steady growth of agricultural credit in the last decade indicates that over the long term the demand is being met by commercial and government-supported sources of credit. In the period 1965–1974 total outstanding farm debt rose by record amounts from $40 billion in 1965 to $93 billion in 1974, an increase of 142 percent.[1] In the last four years alone farm debt has increased by $33 billion for an average annual increase of 14 percent. The boom in farm debt is expected to continue into 1975 as reflected in the U.S. Department of Agriculture's projected increase of nearly $15 billion, assuming the current level of interest rates is maintained.[2]

Both real estate and non-real estate farm debt have registered strong advances over the past decade. Non-real estate debt rose more rapidly (142%) than real estate debt (123%) and the increase in non-real estate debt was substantially larger in dollar volume ($53 billion) than real estate debt ($26 billion). The sharpest rise in outstanding farm debt occurred between 1970 and 1974 when real estate debt rose from $30 billion to a total of $47 billion and non-real estate debt increased from $30 billion to $46 billion.[3]

The recent surge in farm borrowing reflects shifts in a number of factors which affect both the demand for, and the supply of, loan funds. Lenders were motivated to provide a larger volume of loan funds to farmers by more competitive yields

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[1] See Appendix Table 1.
[2] Agricultural Financial Outlook, December 1974, p. 19.
[3] See Appendix Table 1.

and lower risks on farm loans, and strong deposit inflows. Farm borrowing, on the other hand, has expanded to accommodate the shift toward all-out production, larger capital investment and operating inputs, and the rising cost of virtually all farm inputs.[4]

Institutional lenders have been the major source of credit in meeting the booming demand for farm loans. In the farm mortgage market, commercial banks and Federal Land Banks have made the most significant contributions, although the bulk of farm real estate debt is held by individuals and others.[5] As of the end of 1974 preliminary data show that Federal Land Banks held real estate debt of $13.4 billion; commercial banks approximately $6 billion and individuals $18.4 billion. Over the past ten years the volume of outstanding real estate debt held by Federal Land Banks increased by 216 percent while commercial banks increased their holdings by 189 percent and individuals by 129 percent.[6]

The rapid increase in Federal Land Bank lending partially reflects new provisions established by the Farm Credit Act of 1971 and implemented in the spring of 1972. Prior to the Act, Federal Land Bank loans were restricted to 65 percent of the "agricultural value" of the supporting real estate collateral. The new Act raised the ceiling to 85 percent of the "market value" of the mortgaged real estate.[7]

Commercial banks held their share of outstanding farm real estate debt relatively constant at 13 percent in the last decade although farm real estate debt more than doubled. Federal Land Banks, on the other hand, expanded their share of farm real estate debt in this period from 20 to 28 percent. Federal Land Banks were helped in expanding their share of the outstanding farm real estate debt by their direct access to the national capital and money markets and by their ability to offer credit in accounts not restricted by fund supply factors that have limited the funds rural commercial banks have available for farm loans.[8] Life insurance companies' share of farm real estate debt fell sharply from 23 percent in 1965 to 14 percent in 1974 due to a shift in lending to other investment alternatives following the 1969–70 credit crunch and an increase in policy loans.[9]

Commercial banks, individuals and merchant dealers are the largest source of non-real estate credit. At the close of 1974 commercial banks held $18 billion of non-real estate debt or approximately 40 percent of all such outstanding debt; individuals and merchant dealers held $17 billion of non-real estate debt or 36 percent of the total and the remaining 24 percent was held by Production Credit Associations (21%), Farmers Home Administration (2%) and Federal Intermediate Credit Banks (1%).

The share of non-real estate debt held by commercial banks has held relatively constant at approximately 40 percent over the last decade, while the share held by individuals and merchant dealers declined from 42 percent in 1965 to 36 percent in 1974. Production Credit Associations have offset this decline by increasing their share from 14 percent in 1965 to 21 percent in 1974.[10] The curtailment of credit extended by merchants and dealers represents the most significant recent change in agricultural credit. Confronted with high costs of borrowed money and short supplies of feeds, fertilizers, petroleum products and farm machinery, merchants and dealers in 1973 began a drastic reduction of the level of sales financings.[11]

B. DEVELOPMENTS IN AGRICULTURAL CREDIT, 1974–1975

That the credit needs of agriculture are currently being met is indicated by the growth of real estate and non-real estate debt in 1974 and in the early months of 1975. Outstanding farm real estate debt increased 15 percent and non-real estate debt 9 percent in 1974. These increases were achieved despite an appreciable tightening of funds for lending at rural banks due to a slowing in deposit growth and an expanding loan volume which raised loan-to-deposit ratios among rural

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[4] "Concern for Growing Farm Debt", *Business Conditions*, Federal Reserve Bank of Chicago, June 1974, pp. 8–9.

[5] Individuals and others represent a broad category of lenders who hold roughly two-fifths of all non-real estate and real estate debt outstanding. The bulk of non-real estate debt held by individuals and others represents short-term credit extended by merchants and dealers in agricultural supplies. The majority of farm real estate debt held by individuals and others is held by the sellers.

[6] See Appendix Table 1.

[7] *Op. Cit.*, Business Conditions, p. 9.

[8] Emanuel Melichar, "Aggregate Farm Capital and Credit Flows Since 1950 and Projections to 1980", *Agricultural Financial Review*. July 1972.

[9] *Op. Cit.*, Business Conditions, p. 9.

[10] See Appendix Table 1.

[11] "Financing Modern Agriculture", Remarks by Dr. Gene L. Swackhamer, Deputy Governor, Office of Finance and Research, Farm Credit Administration, before the Agricultural Credit Forum, Wichita, Kansas, April 17, 1975.

banks.[12] Commercial banks continued to experience strong demands for agricultural credit in the early months of 1975 due in part to the slowing in the rate of loan repayments and a rise in the volume of loan renewals and extensions. On the other hand, availability of funds has eased and interest rates have declined moderately. In the first quarter of 1975 non-real estate loan demand exceeded the same period in 1974. Several interrelated factors were responsible, namely, the high cost of farm inputs; prospective large crop plantings; a high level of borrowing for machinery and equipment; and more restrictive credit policies of merchants and dealers.[13]

The easing of fund availability in 1975 appears to be more a reflection of the changing of bank asset portfolios than deposit growth or loan repayments. While deposits are up, agricultural loan growth at rural banks has shown even larger increases. Lendable funds generated by loan repayments appear to be comparatively low. Asset restructuring is being brought about by the decline in rates of interest on money market instruments. This discourages bankers' purchases of government securities and Fed funds and encourages the realization of capital gains through the sale of high-interest bearing securities.[14]

While the issue of the adequacy of financing to maintain agricultural operations has been widely debated in recent months, most bankers feel that farmers will receive adequate credit. There is, however, the possibility that inadequate credit may prevent a few farmers from maintaining the acreage planted in 1974, particularly those who fail to receive extensions and/or refinancing of 1974 loans; those who cannot obtain additional merchant and dealer credit; and those whose equity has been substantially reduced.[15]

C. ADEQUACY OF AGRICULTURAL CREDIT IN 1975 AS VIEWED BY IBAA MEMBERS

A canvass of a random sample of IBAA members in rural areas was undertaken last month to provide this Committee with a current grass roots view of the agricultural credit situation. Generally, the survey revealed that our member banks were meeting the credit needs of their farm customers. In the opinion of 97 percent of the banks canvassed, farmers in their areas were currently receiving an adequate supply of credit either from their banks or from other sources. While our member rural banks' total loans and deposits grew at approximately the same rate (7 percent) between June 1974 and June 1975, residential housing loans increased by 12 percent; real estate loans secured by farmland rose by almost 10 percent; and other commercial and industrial loans not secured by real estate grew by more than 11 percent.

Most of the survey respondents reported increases in operating loans and farm machinery loans. On the other hand, a majority experienced a decline in the volume of livestock loans. No change in the volume of crop storage loans and dairy operation loans was indicated by those reporting. The principal factor responsible for the increase in operating and farm equipment loans was the tightened credit policies of merchants in the sale of fertilizer, fuel, feed and machinery as well as the extension and/or refinancing of 1974 loans.

Most of the rural banks responding to our survey indicated that their loanable funds exceeded the demand for loans and viewed their loanable funds to be in good balance with loan demand. Those banks reporting loan demand in excess of loanable funds closed the gap by a) selling participations to correspondent banks; b) selling participations to other banks in their area; c) participating in loans with Farmers Home Administration; and d) purchasing federal funds.

A mere handful of survey respondents reported that they had obtained additional loanable funds from Production Credit Associations (PCAs) or Federal Intermediate Credit Banks (FICBs). This confirms the finding of the Committee on Rural Banks Problems that while commercial banks may discount farm loans with FICBs, they seldom have used the discount mechanism. The failure of rural bankers to use FICB or PCA sources of funds is due in part to their reluctance to utilize a source of funds controlled by their major lending competitors—the PCAs—and the unwillingness of many FICBs to discount loans for bankers. In periods of severe monetary restraint the Farm Credit System has been reluctant to accommodate expanded discounting by banks when the cost of funds was high. The indications are clear, therefore, that the FICB discount mechanism does not

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[12] *Agricultural Credit 1974/75*, Federal Reserve Bank of Chicago, *Business Conditions*, Federal Reserve Bank of Chicago, January 1975, p. 13.
[13] *Agricultural Letter*, Federal Reserve Bank of Chicago, May 2, 1975.
[14] *Idem.*
[15] *Idem.*

offer a means of ameliorating the farm credit problems of rural banks (Report of the Committee on Rural Banking Problems, Board of Governors of the Federal Reserve System, June 1975, Appendix A, pp. 8–9).

About half of the banks responding to our inquiry received loan applications from acceptable farm borrowers that exceeded their loan limits. In most cases these banks obtained correspondent bank participation to overcome the overline limits. Approximately 37 percent of the surveyed banks had loan limits over $100,000; 15 percent had loan limits between $75,000 and $100,000; 25 percent had limits of $50,000 to $75,000; and the loan limits of the remaining 23 percent were under $50,000.

Looking ahead, 97 percent of the responding rural banks were optimistic as to their ability to meet future increases in the credit needs of the farmers in their area. When questioned as to how they would meet the anticipated growth of credit demand, most expected to rely on the growth of deposits, capital, and surplus. Others planned to utilize the participation of correspondent banks or other area banks and to a limited extent government farm credit agencies. Only a handful of respondents were pessimistic about their ability to meet the rising credit needs of their rural customers.

To assist rural banks in meeting the present and future needs of agriculture many respondents urged that: (a) closer cooperation of Farmers Home Administration, Federal Land Banks, and Production Credit Associations with rural banks be developed; (b) the FmHA program be expanded and its guaranteed loan limits be raised; (c) the Federal Reserve provide discount programs for rural agricultural loans of non-member banks; (d) government agencies make the procedures for loan participations less cumbersome; and (e) the Rural Development Act be fully implemented and that it be made a more useful vehicle for small business loans in rural areas.

One of the most significant revelations of our survey was the inability of rural banks to make effective use of the loan program of the Rural Development Act of 1972. Less than 10 percent of the survey respondents had participated in the program as of June 1, 1975. Only 201 loans had been made under the program by IBAA banks reporting, of which 72 percent were farm operating loans; 23 percent farm ownership loans; and the remaining 5 percent business and industrial loans. One of the principal reasons given for the failure of our banks to participate in the RDA program was lack of familiarity with the program and excessive paperwork which suggests failure on the part of the government to adequately publicize the program.

Among the most frequently cited factors which it is believed will affect the future availability of credit for agriculture and rural development were: the impact of state usury laws which limit deposit growth in periods of rising interest rates; correspondent bank relationships and the growth of branch banking. Of lesser impact were the introduction of electronic funds transfer systems and a number of miscellaneous factors such as the Real Estate Settlement Procedures Act and the burdensome paperwork involved in many government procedures.

D. IMPACT OF A BUMPER CROP ON LOAN REPAYMENT SCHEDULES AND FARM DEBT

Historically agriculture has experienced a series of crises since the 1930s and there are some who are fearful that another crisis is approaching. Traditionally, a cyclical reaction tends to follow every war period. In the past some agricultural crises have precipitated a wave of farm mortgage foreclosures. Today's price instability, accompanied by rising costs and the absence of a floor on farm prices, could precipitate a collapse more serious than any experienced in the last 25 years.

When farm prices decline below production costs, losses are experienced that force the conversion of short term borrowing to long term mortgage debt. If the losses persist mortgage foreclosures follow, as in the 1920s. Some experts see a major capital crisis in agriculture next year. Farmers who have not paid off last year's debt will be squeezed if they fail to get good crop prices this year and many may experience foreclosures and repossessions next year.[16]

On the other hand, most farmers have tremendous equity in their land which enables them to stretch out their payments. Moreover, farmers are somewhat protected by land values, which continue to rise despite the recession and falling crop prices. But it appears that the land-value boom of 1973 has ended and demand for farm land has begun to slacken. According to the Federal Reserve

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[16] *Business Week*, June 2, 1975, p. 38.

Bank of Chicago, farmland prices increased in the first quarter of 1975 only 2 percent from last year, the smallest quarterly increase in three years. Consequently, land values in April were only 14 percent above a year ago.[17]

Many farmers are securing funds to pay off old debt as well as to finance current crops by mortgaging land and equipment, much of which had been paid off after the high-profit years of 1973 and 1974. However, mortgaging land to provide cash is tantamount to selling assets to stay afloat and may be delaying rather than avoiding a crisis.[18]

A big harvest this year may signal the end of the farm boom and there is talk of an agricultural recession and a farm "price bust" in the farm country. In 1973 net income realized by farmers reached a record $32.2 billion and disposable per capita income topped that of the nonfarm population for the first time since records have been kept. Last year, realized net income fell 16 percent to $27.2 billion. Falling commodity prices along with still rising production expenses may depress net income to about $20 billion this year. Therefore, some authorities see the beginning of an agricultural recession, especially if the farmer's expenses keep rising. The Agriculture Department, while admitting that the price-cost squeeze is pinching harder, does not anticipate a real old fashioned agriculture depression. The squeeze will hit hardest the new farmers and farmers who over-expanded and paid high prices for land, equipment and other production needs.[19]

The Department of Agriculture last December projected substantial carryovers of 1975 crops of corn and soybeans which may necessitate liberalization of the government's crop-loan program despite Agriculture Secretary Butz's policies designed to reduce the government's role in agriculture.[20]

E. ADEQUACY OF CREDIT FOR RURAL DEVELOPMENT

While the credit needs of agriculture, as measured by the volume of credit extended for farm real estate and operating loans, are being met, there is a clear and present need to increase the supply of funds for community development in rural America. Although the Congress took affirmative steps to increase the flow of funds to rural communities for community development by enactment of the Rural Development Act in August 1972, thus far the legislation has produced minimal results.

The Rural Development Act authorized numerous rural assistance measures designed to attract business and industry to rural areas; to create jobs; and to improve the living conditions of rural citizens. Probably the most important rural assistance measures were the business and industrial and the community facilities loan programs implemented by the Farmers Home Administration. These programs have been funded at only a modest level and their impact has been small. In fiscal year 1974 $200 million was authorized for guaranteed and insured business and industrial loans; $50 million for direct community facility loans, and $10 million for industrial development grants to rural communities. These funds were to be allocated among the states on a formula basis taking into account rural population and per capita income. Under this formula the average allocation of business and industrial loans per state was $4 million in fiscal 1974 and the per state allocation for industrial development grants $200,000.[21]

Inadequate funding of rural development programs in the fiscal year ending June 30, 1974, was largely responsible for the failure of the Rural Development Act to introduce new rural assistance programs or to amplify and extend existing programs.[22] Senator Talmadge, Chairman of the Senate Agriculture and Forestry Committee, views the Rural Development Act as having the potential to provide thousands of jobs and business opportunities, if properly implemented. In his view it can extend assistance to local lending institutions so that they can provide the essential capital for business expansion. The Act provides for 90 percent guarantees by the FmHA of loans by commercial banks and other private lenders to rural business and industry. FmHA guaranteed $200 million in rural business and industry loans in fiscal 1974. It asked for $400 million for the fiscal year ending June 30, 1975, but Congress set a $350 million ceiling. During the first six months of fiscal 1975, July through December the FmHA guaranteed 110 business and industry loans for $45.4 million.[23]

[17] *Ibid*, p. 39.
[18] *Idem.*
[19] *Wall Street Journal*, July 7, 1975, p. 1.
[20] *Idem.*
[21] "Implementing the Rural Development Act", *Ninth District Quarterly*, Federal Reserve Bank of Minneapolis, Feb. 1974, pp. 7–9.
[22] *Idem.*
[23] *American Banker*, January 16, 1975.

Representative Rose, Chairman of the Subcommittee on Family Farms and Rural Development of the Committee on Agriculture, recently pointed out that the Department of Agriculture has used little of the authority given it under the Rural Development Act to improve the quality of life in rural America. He charged that the Department of Agriculture has failed to carry out the assistance to the small cities and towns of this country envisioned by the Act. Expanded grant and loan programs for water and sewer construction in rural America have not been implemented; the mandate of Congress to provide adequate rural housing through rent supplements has been ignored; and a program of rural community fire protection has been totally neglected. Every time rural development comes up for funding, the Administration has consistently refused to request the funding despite the intent of the Congress to make the Act a vehicle to channel the tax dollars of rural America back to their communities.[24]

In testimony before the Subcommittee on Rural Development of the Senate Committee on Agriculture and Forestry in May 1974, I pointed out IBAA's concern with respect to the delay in implementing the Rural Development Act; the lack of a suitable secondary market for Farmers Home Administration guaranteed loans; and the inadequate loan limits for farm ownership and operating loans. IBAA has strongly supported the objectives of the Act and has urged its member banks to participate in its implementation. A survey of IBAA member banks in 1974 revealed the membership's continuing desire for and willingness to assist in making the Act achieve its purposes. However, there is little that rural bankers can do to assist in achieving the objectives of the Rural Development Act so long as government funding continues to be inadequate.

In addition, rural bankers have been hampered in making loans under the Rural Development Act by the lack of clear rules and procedures to be followed under the statute. For example, with respect to a $40,000 loan application of a small steel fabricating and manufacturing company which seemed to meet FmHA requirements, FmHA policy required that any business loan of less than $350,000 must first be offered to the Small Business Administration.[25]

An IBAA member whose bank is located in a rural Nebraska community reports that his opportunity to utilize the rural development loan program in his small farming community of 900 people arose when the town's only industry, a cheese plant, sought financial assistance to expand the city's sewer system, an essential preliminary to increasing production and employment. The cheese plant could not bear the $300,000 to $500,000 cost of expanding the system nor could the city borrow that amount of money against its assessed valuation of $1.1 million. Last fall our member banker, members of the city council and directors of the cheese plant met with the state FmHA representative who advised that funds were not available for this project. I cite this as an example of frustration of the intent of the Congress to provide financial assistance of this kind for the development of rural America.

II. The Role of Rural Bankers in Meeting the Credit Needs of Agriculture and Alternative Institutional Arrangements Which Might Facilitate Credit Flows to Agriculture

Rural banks are often the principal suppliers of credit used by farmers and small businesses and these borrowers prefer to rely on private financial institutions rather than federal credit programs to meet their credit needs. This view rests on the proposition that the private sector can usually deal more effectively with the novel credit demands or those that are unique to certain regions or require some departure from traditional financing methods.[26]

A rough measure of the role commercial banks now play in rural areas is the loan-deposit ratio of rural banks. Generally, rural banks throughout the United States have a smaller percentage of their deposits loaned out than urban banks and a larger percent invested. For example, the loan-deposit ratio of rural banks in the Ninth Federal Reserve district in mid-1973 was 58.6 percent compared to 73.3 percent for urban banks, while the investment-to-deposit ratio was 15.1 and 10.4 percent respectively.

Rural areas, particularly in the Midwest, have traditionally been served by small unit banks. With the demand for larger rural loans the resources of these banks have become increasingly strained. Most rural banks are too small to participate in the national money markets, so their lending abilities depend primarily on local

[24] *Congressional Record*, June 18, 1975, pp. H5676–77.
[25] Testimony of Pat DuBois before the Subcommittee on Rural Development of the Senate Committee on Agriculture and Forestry, May 8, 1974.
[26] "Financing Rural Enterprise", *Ninth District Quarterly*, Federal Reserve Bank of Minneapolis, August 1974, p. 10.

deposit growth. Slow population and employment growth in rural areas results in relatively slow deposit expansion and severely limits the lending ability of these banks. Consequently, rural banks' ability to meet the demand for more and larger rural loans will depend upon their ability to rely on funds raised in national money markets.[27]

Because rural banks are affected by the seasonal credit demands of agriculture and tourism they acquire short-term assets during periods when seasonal pressures are low and dispose of them as seasonal needs expand. The seasonal influence has two adverse effects on a bank's ability to lend. First, the supply of funds available to satisfy intermediate and long-term loans is limited by the supply of funds available; and second, rural banks have only a limited amount of funds to meet seasonal borrowing needs.[28]

In 1973 the Federal Reserve System amended Regulation A to provide eligible member banks a "seasonal borrowing privilege" which permits them to obtain funds from their Federal Reserve Banks on a temporary basis to meet seasonal credit requirements. Eligibility for these funds rests on four considerations: (a) lack of access to money markets; (b) demonstrate a seasonal need for funds; (c) the seasonal pattern must persist for at least eight consecutive weeks; and (d) the bank can obtain a limited amount of credit determined by a formula relating seasonal needs to deposits. The effect this borrowing privilege can have on increasing the supply of funds available to rural banks is limited since only members of the Federal Reserve System can use it and a very large percentage of rural banks are not system members. To make the privilege more effective legislation proposed by the Board of Governors in 1974 to extend the privilege to all non-member banks should be enacted by the Congress.[29]

In 1970 the Board of Governors of the Federal Reserve System established a study committee to continue investigation of rural banking problems that had been pointed out in the "Report of a System Committee" as part of the *Reappraisal of the Federal Reserve Mechanism.* The central cause of these problems, as described in that report, is the inability of small banks—as sellers of assets or liabilities—to raise funds effectively in the nation's financial markets. In a report released last month the committee proposed that the Federal Reserve System act to improve the ability of smaller banks to obtain non-local funds through: (1) vigorous promotion and efficient administration of the new seasonal borrowing privilege, plus implementation of a basic borrowing privilege for small banks; (2) initiation of efforts to establish or improve mechanisms for marketing of negotiable instruments issued by small banks; (3) improvement of the ability of small banks to originate and market finance acceptances; and (4) revision of correspondent banking practices to reduce the proportion of funds absorbed by correspondent balances.[30] We urge the Federal Reserve Board to give serious consideration to the recommendations of the study committee and to take prompt action toward their implementation.

There are, however, observers who advocate structural changes in the present banking system to better equip rural banking to serve the credit needs of modern large-scale farm and business enterprises. They view a branch banking system or a multibank holding company system as possible improvements. Empirical studies have not supported this view.[31] Examination of the most common indicators of economic performance does not reveal any systematic or readily discernible relationship between a state's style of banking structure and its tempo of economic growth. Some measures of economic growth and banking performance tend to favor states with statewide branching while other measures lean toward unit and limited branching states.[32]

We, as advocates of unit banking, content that: (1) branching and similar structural changes disrupt the close identification of rural bankers with their market; (2) while rural bankers may serve a small market area they can diversify their portfolios through participations with correspondent banks; (3) there is no evidence that small branch banks in rural areas would be able to pull funds from larger urban banks in the system to make loans to rural enterprise; (4) branching

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[27] *Ibid*, pp. 14–15.
[28] *Ibid*, p. 15.
[29] *Idem.*
[30] *Improved Fund Availability at Rural Banks*, Report and Study Papers of the Committee on Rural Banking Problems, Board of Governors of the Federal Reserve System, June 1975.
[31] *Op. Cit., Ninth District Quarterly*, p. 16.
[32] Jerome C. Darnell, "Does Banking Structure Spur Economic Growth?" *Business Review*, Federal Reserve Bank of Philadelphia, November 1972, p. 22.

does not transfer more money into rural areas but instead enables deposits collected from rural areas to be more easily shifted to urban areas where credit demand and interest rates are higher; and (5) claims that small unit banks tend to monopolize their communities are not justified since rural business people are mobile and can seek the services of banks in neighboring areas when dissatisfied with their hometown banks.[33]

III. Congressional Action To Insure the Competitive Viability of the Nation's Independent Banks

One of the major concerns of independent banks which should be given prompt and thorough Congressional attention is the growth of concentration in commercial banking and the continuing erosion of the independent banking sector attributable to the growth of multibank holding companies. Although bank holding company growth slowed after passage of the 1970 amendments to the Bank Holding Company Act, the share of commercial bank deposits held by bank holding companies continued upward from 55 percent in December 1971 to 65 percent in December 1973.

By year end 1973 bank holding companies controlled more than 60 percent of commercial bank deposits in each of 21 states. Furthermore, the five largest banks (mainly multibank holding company banks) controlled more than 85 percent of deposits in the state's major metropolitan markets in 13 of these states.

Nearly all of the Nation's largest banks are now owned by multibank holding companies. In numerous states, especially those with unit banking or restricted branching, the bank holding company movement, has, since 1970, entailed a rapid consolidation of banking units.[34] As the bank holding company movement has matured, however, some fundamental changes in the direction and speed of holding company expansion have become apparent. A reduction in bank holding company expansion occurred in 1974 due largely to a "go slow" policy by the Federal Reserve Board of Governors, reflected in the increased number of denials of holding company applications; and to a drastic decline in the price of bank holding company stock which increased the difficulty of making acquisitions of other banks.[35]

While the Fed was belatedly tightening its policy toward bank holding company growth, a countervailing policy toward bank holding company growth by acquisition was established in 1974 by the Supreme Court in its landmark decision in *United States* v. *Marine Bancorporation, Inc., et. al.*[36] In this antitrust case the Government challenged an acquisition by a bank holding company of a bank in a geographic market other than the one in which it was a competitor, on the ground that it would lessen the competitive potential of the bank holding company. In its decision the Supreme Court held that in applying the doctrine of potential competition to commercial banking, courts must take into account the effect of extensive federal and state regulation of banks, and in particular, state statutory barriers to *de novo* entry and to expansion following entry into a new geographic market.[37] In effect the decision removes the restraints of the Clayton Act from geographic market extension mergers by bank holding companies in any state which limits branching or restricts the activities of bank holding companies. Thus, in 31 states where such state limitations exist bank holding companies can acquire independent banks outside their geographic markets relatively free of antitrust law constraints.

In a more recent decision in *U.S.* v. *Citizens and Southern National Bank et. al.*, the Supreme Court further limited the effectiveness of the antitrust laws in restraining the growth of bank holding companies by acquisition or merger. Justice White, in a minority opinion, pointed out that the decision permits the dominant commercial bank in Atlanta further to entrench its position and that two other rivals, which together with C&S control more than 75 percent of the banking

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[33] *Op. Cit., Ninth District Quarterly*, p. 13.

[34] Samuel B. Chase, Jr. and John J. Mingo, "The Regulations of Bank Holding Companies", a paper presented at the December 1974 meeting of the American Economic Association, p. 3.

[35] *Business Conditions*, Federal Reserve Bank of Chicago, February 1975, p. 3. While the total number of bank holding company and merger applications acted upon by the Fed fell from 717 to 671 in 1974, a 6.4% decline, the "denial rate" increased significantly from 4.3% in 1973 to 7.1% in 1974. However, the rate of rejections of bank holding company formations was largely responsible rather than an increase in the rate of rejections of acquisitions.

[36] (418 U.S. 602.)

[37] *Idem.*

business in Atlanta, would probably follow suit, further increasing concentration in this market.[38]

The full effects of the *Marine Bancorporation* and *Citizens and Southern* decisions will be felt when the market prices of bank holding company stock move up from their still depressed levels. Once bank holding company stocks reach higher levels a tidal wave of acquisitions can be anticipated which will sweep across the independent banking sector in each of the 31 states where antitrust constraints have been weakened. Congress should examine the effects of this loophole in the antitrust laws on banking before it is too late to close it.

Another aspect of bank holding company growth which requires Congressional inquiry is the growing number of financially related fields that bank holding companies have entered since the 1970 amendment to the Bank Holding Company Act. By the end of 1974 the Federal Reserve Board had approved 21 general classes of nonbank activities which were so closely related to banking as to be a proper incident thereto and permissible for bank holding companies.[39]

The growth of nonbank activities of holding companies has raised new supervisory problems with respect to the Board's responsibilities to protect the interest of depositors and to preserve public confidence in the ability of banks to meet all of their obligations. Activities being pursued by bank holding companies fall well outside the traditional purview of bank regulation and expose holding companies to losses which could be substantial. In addition many bank holding companies have been financing their diversification partly through the issuance of considerable amounts of commercial paper and long-term debt, raising questions as to the adequacy of capital.[40]

Protection of subsidiary banks from misfortunes of holding company affiliates, or improper transactions with them, is presently provided largely by laws and regulations dealing with banks, rather than by those dealing with holding companies. Three Federal agencies have authority to regulate and supervise banks controlled by holding companies. Each has authority to take action against unsafe or unsound banking practices by banks, but no authority with respect to such practices by bank holding companies. The Federal Reserve Board has asked Congress for such authority with respect to bank holding companies.[41]

One of the major factors influencing the owners or stockholders of independent banks to dispose of their interest to multibank holding companies is the savings available to them through an exchange of stock under the capital gains tax. In many cases it is clear that the capital gains tax saving constitutes the major reason for the sale of an independent bank to a multibank holding company. Congress should give thorough study to the means of fostering the transfer of ownership of independent banks to interests other than multibank holding companies by making it equally attractive, tax-wise, to sell a bank to another independent entity as it presently is to sell to a multibank holding company. Such tax treatment would go a long way toward halting the growth of multibank holding companies at the expense of independent banking.

A major threat to the viability of independent banking in the United States is the headlong, haphazard, unsystematic rush into the new technology of electronic funds transfer systems. IBAA supports the development and introduction of the new technology but fears that its full scale introduction without adequate experimental operation could produce irreversible errors which would have detrimental long term effects on the competitive structure of the nation's financial institutions. It is for this reason that we were staunch advocates of the legislation which called for the creation of the National Commission on Electronic Fund Transfers and was signed into law by President Ford in October 1974.[42] It is the responsibility of the Commission to conduct a thorough study of all the ramifications of electronic funds transfer systems and to recommend appropriate administrative action and legislation necessary in connection with the development of public or private electronic fund transfer systems. The Commission's interim report of its findings and recommendations was to be made to the President and the Congress within 18 months (approximately March 1976).

Eight months have elapsed and the Commission has not yet been appointed. In the interim, actions taken by the Federal Home Loan Bank Board and the Comptroller of the Currency have authorized many financial institutions to put into

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[38] Supreme Court opinion of June 17, 1975.
[39] *Op. Cit.*, Business Conditions, February 1975.
[40] *American Banker*, July 8, 1974.
[41] *Idem.*
[42] H.R. 11221, The Depository Institutions Amendments Act of 1974. (Public Law 94-945.)

place permanent EFTS systems and a number of state legislatures have enacted hastily considered EFTS legislation to preserve the competitive position of state chartered financial institutions against the advantages provided federally chartered financial institutions.

Congress should inquire into the delay in the establishment of the National Commission on Electronic Fund Transfers and the competitive impact further delay will have on the competitive position of the independent banking system.

The House Banking, Currency and Urban Affairs Committee has announced that it is undertaking a broad study of the nation's financial institutions identified as the FINE Study. This is a study paralleling that of the Hunt Commission which formed the basis for the proposed Financial Institutions Act now being considered by the Congress. We urge that the FINE Study include a thorough examination of the role of rural commercial banks in meeting the credit needs of American agriculture and to determine how they can better meet the credit requirements of this important sector of our economy.

IV. Summary and Recommendations

1. The Federal Reserve Board should implement the following recommendations of the Committee on Rural Banking Problems:

a. Improve the access of member and non-member small banks to the principal money markets: (1) by acting as broker for the sale, in the open market, of agricultural loans; and (2) by establishing a mechanism for assembling and pooling of special time deposit certificates from small banks and periodically conducting an auction of large-denomination participations in the pool of these certificates.

b. Expand the supply of loanable funds available to small banks, which cannot raise funds elsewhere, by working out arrangements whereby correspondent banks would receive payment of services provided to small banks, on a reasonable fee basis, rather than by requiring the maintenance of compensating balances.

2. The Congress should enact legislation which would extend to non-member banks the seasonal borrowing privilege presently available, through the Federal Reserve Banks' discount mechanism, only to member banks.

3. The Congress should investigate the effectiveness of the administration of the Rural Development Act by the Farmers Home Administration to determine (a) what steps should be taken to make the Act more effective in the achievement of its objectives and (b) the adequacy of the funds appropriated for the funding of the Act's various programs.

4. Congress should initiate a comprehensive examination of (a) the present structure of commercial banking and the trend toward increasing concentration resulting from the growth of bank holding companies through mergers and acquisitions of independent banks; and (b) the growing number of financially-related fields that bank holding companies have entered since the 1970 amendment to the Bank Holding Company Act, with particular reference to the effect of such expansion on the adequacy of bank capital and the impact of this growth on competition in the bank-related fields.

5. The Congress should examine the adequacy of the antitrust laws to deal with bank holding company acquisitions of independent banks which may lessen actual or potential competition. Limitations have been imposed on the antitrust enforcement agencies by the recent decisions of the Supreme Court in *U.S.* v. *Marine Bancorporation, Inc. et. al.*, and *U.S.* v. *Citizens and Southern National Bank, et. al.*

6. The Congress should act favorably upon the request of the Federal Reserve Board for authority to deal with the problem of protecting subsidiary banks from the misfortunes of holding company affiliates or improper transactions with them. This authority presently is dispersed among three Federal agencies, each of which may take action against unsafe or unsound banking practices by banks, but there is no authority with respect to such practices by bank holding companies.

7. Congress should examine the feasibility of granting the stockholders of independent banks relief from the capital gains tax in order to foster the transfer of ownership of independent banks to interests other than multibank holding companies by making it equally attractive, tax-wise, to sell to another independent entity as it is to sell to a multibank holding company.

8. Congress should undertake an immediate inquiry into the reason for the delay in appointing the member of the National Commission on Electronic Fund Transfers which was signed into law by President Ford in October 1974 and to urge the prompt creation of the Commission. The delay in appointing the Com-

mission has permitted the full-scale introduction of EFT systems without adequate experimentation. This could have detrimental long term effects on the competitive structure of the nation's financial institutions.

9. We urge the House Banking, Currency and Urban Affairs Committee to include in its ongoing FINE Study a thorough examination of the role small rural banks play in meeting the credit needs of the nation's farmers and rural communities. How to expand the supply of loanable funds needed to meet the growing demands for agricultural credit should be a prime objective of the study.

APPENDIX TABLE 1.—AGRICULTURAL REAL ESTATE AND NONREAL ESTATE DEBT OUTSTANDING, DEC. 31, 1965–74

[In millions of dollars]

Debt held by	1965	1966	1967	1968	1969	1970	1971	1972	1973	[1] 1974
Real estate debt:										
Federal land banks	4, 204	4, 914	5, 563	6, 801	6, 671	7, 145	7, 880	9, 050	10, 902	13, 402
Life insurance companies	4, 802	5, 214	5, 540	5, 764	5, 734	5, 610	5, 564	5, 643	5, 965	6, 470
Commercial banks	2, 607	2, 770	3, 060	3, 333	3, 545	3, 773	4, 218	4, 702	5, 458	5, 966
Farmers Home Administration	1, 497	1, 663	1, 844	2, 054	2, 280	2, 440	2, 618	2, 835	3, 013	3, 000
Individuals and others	8, 040	8, 516	9, 135	10, 165	10, 953	11, 378	11, 927	13, 437	15, 915	18, 400
Total real estate	21, 186	23, 077	25, 142	27, 297	29, 183	30, 346	32, 207	35, 757	41, 253	47, 283
Nonreal estate debt:										
Production credit association	2, 579	3, 016	3, 518	3, 826	4, 495	5, 295	6, 078	6, 607	7, 829	9, 519
Federal intermediate credit banks	139	157	176	180	218	220	237	251	331	374
Commercial banks	7, 677	8, 534	9, 272	9, 720	10, 330	11, 102	12, 498	14, 315	17, 167	18, 238
Farmers Home Administration	717	737	798	821	785	795	771	781	877	1, 054
Individuals and merchant dealers	7, 880	8, 820	9, 760	10, 320	11, 230	12, 340	13, 700	15, 360	15, 900	16, 690
Total nonreal estate	18, 992	21, 264	23, 524	24, 867	27, 058	29, 752	33, 284	37, 314	42, 104	45, 875
Total debt outstanding	40, 178	44, 341	48, 666	52, 264	56, 214	60, 098	65, 491	73, 071	83, 357	93, 113

[1] Preliminary Data, U.S. Department of Agriculture.

Source: "41st Annual Report of the Farm Credit Administration and the Cooperative Credit System 1973–1974", appendix tables 4 and 5.

Chairman HUMPHREY. I would like to quickly say to the staff that I would like you to excerpt from the testimony of Mr. DuBois those provisions which relate to the Rural Development Act and send to Chairman Talmadge of the Committee on Agriculture, to Senator Clark, who is currently subcommittee chairman, and have a copy for me. I'm the author of that act, and also a member of the subcommittee. That's number one.

Second, regarding those provisions which relate to the banking system—I think you could send the whole testimony to Congressman Reuss and to Senator Proxmire and to members of the banking committees. I believe that those committee chairmen should hear from us on the basis of the testimony that has been given here today. And I would like to see those letters before they go out to make sure that we have got what we want in them.

We have got a lot of questions here. And I hope that we will have time to go through a few of them. I need a little help here I think from my associate.

This question can be first addressed to Mr. Klutznick and Mr. Thurow, Secretary Simon, as you know, and the President and others, including Chairman Burns of the Fed, still claim that inflation is our No. 1 problem. The administration, as you have indicated in your respective bits of testimony, was late to accept the wisdom of a

tax-cut to stop the slide in unemployment. And I might add on my own that they fought very vigorously against a larger tax-cut than Congress passed, on the fear that it would be inflationary. The president has vetoed two major bills for public service jobs and housing that were designed to cut unemployment, on the fear again that it would be inflationary. I don't think it is an exaggeration of the administration's position that a concern over inflationary pressures is a living fact of life with them, and that any legislation that seems to go beyond the administration proposals is immediately doomed to veto in the name of fighting inflation.

The Wall Street Journal just this last Tuesday carried a front-page story noting that we have the highest unemployment rate of any of the nine largest industrialized nations. Based on U.S. unemployment concepts, France had 4.9 percent unemployed in May; Canada, 7.3; Germany, 3.2; and Great Britain, 3.6 percent. And I think that at that time Japan maybe had about 5 percent.

The latest University of Michigan Survey Research Center poll of consumer confidence—and they have been doing that, as you know, on a regular basis—released Monday; revealed that unemployment, not inflation, is considered our No. 1 problem. Sixty-four percent said that.

Now, I put the question directly to both of you gentlemen. Do you think that the administration is focusing on the wrong problem? To put it another way, should the administration turn its full attention to what a large majority of our citizens view as the major economic problem?

I recognize that public opinion polls or surveys of this kind are sometimes inprecise, they fluctuate with the emotions of the time or the period. But I think the question is genuine and real. Do you think the administration is focusing too much on the inflation problem and not enough on the unemployment problem? And if so, how would you spell that out?

Mr. THUROW. You can answer that kind of a question on two levels. First, even if you think inflation is problem No. 1, does keeping the unemployment rate high reduce the inflationary problem? If you are moving from a 9-percent unemployment rate to a 6-percent unemployment rate, you are not going to be rekindling inflation. You simply are not close to the capacity of the economy.

Even if you think inflation is problem No. 1, that this set of policies doesn't address problem No. 1, it creates problem No. 2.

Second, people often claim that inflation is more of a problem than unemployment simply because everybody suffers with inflation, and only 1 out of 10 from unemployment.

Chairman HUMPHREY. That is right.

Mr. THUROW. I think that is misleading, because the severity on those 1 out of 10 persons is very high.

But the second is, if you look at reductions in hours of work, it is clear that some very extensive fraction of the American population has had a cut in their family's income because of the recession. They may not be unemployed, but they are on a reduced work week in the sense of working fewer hours than they did 2 or 3 years ago. I suspect if you went out and did the economic calculations as to how many families have had cuts in real income because of the high

unemployment and how many families have cut in real income because of inflation, you wouldn't come to the conclusion that inflation is a general evil while unemployment just hurts a few.

Chairman HUMPHREY. Or to put it another way, you would say that unemployment hurts many more than is presently indicated?

Mr. THUROW. It hurts a lot more than just the 8 million or whatever people who are officially counted as unemployed.

Mr. KLUTZNICK. Mr. Chairman, you said a short while ago that which I think applies, and that is, some people are born with short legs.

I think our problem here—I tried to indicate it at my last session with this committee—is that we are reading the past wrong. And we are doing the same things because we have become accustomed to doing them, without recognizing that there has been a great change in conditions. For example, it was possible to absorb higher interest costs with minimum harm, it seems to me, then the period of growing interest costs was 6 to 8 months or a year, and the rates varied from 6 to 7½ or 8 percent. It was another thing when effective rates—including the cost of deposits of compensating balances—suddenly boomed up to 14 and 15 percent, something that never happend before since the war.

The Secretary of the Treasury is completely wrong in his assessment of the rate at which this country should recover. Last night I read his new article in the Saturday Review, the last issue. And it really leaves us in a position of wanting to know whether it is 1975 or 1940 you are talking about.

For example, a first-class economist recently concluded on the basis of the Department of Commerce figures—and I have them in front of me now—that steeper business contractions have generally been followed by smaller net recoveries from the previous peak in GNP.

Now, if you are looking at the figures from 1949 and 1950 on, you get this sort of a reading. There have been five-business cycles. The one we are in now is the sixth. In 1958 dollars, the largest decline over the entire recession was in the period from the third quarter of 1957 to the first quarter of 1958, $17.7 billion; that was the largest. Some of the net declines were as small as $5.5 billion.

If we bottom out in the first quarter of 1975, in 1958 dollars the net decline will have been $65.5 billion.

Now, if it is true, as these figures demonstrate, that the net amount of recovery is less when the rate of decline is greater, then we have not a normal depression problem, we have an extraordinary depression problem. And to treat it with the normal tools or the normal attitude seems to me to be an invitation to trouble. And I don't know why people don't look at these things. It is one thing if you recover from a depression of $17.7 billion, which was our largest, at a normal rate. But if the evidence is that steeper contractions are usually followed by smaller net recoveries, then it is clear that we are going to have to do some extra stimulation this time, if we expect to get out of this without great human suffering.

Chairman HUMPHREY. That's very helpful. And I would hope that those who might review this testimony would note it very carefully.

Now, we do face the prospect of an OPEC price rise in oil. I don't think we can just hope that that is going to fade away.

Also, to be quite honest about it, I think we face the prospect of oil decontrol here on our so-called domestic oil. Now, the Congress is taking a different point of view, of course. The majority in the Congress has voted to continue the program of controls on old oil, and some price rollback on new oil. New oil is up to about $13.50 a barrel, and the rollback is to $11.50. That is equal to removing the $2 tariff imposed on so-called new oil.

Now, if we had oil decontrol, everyone agrees that it is going to have an adverse effect on the economy; it is going to increase prices. The question is whether it is 2 percent in the consumer price index, or 3 percent or 4 percent, but whatever it is, it means higher prices.

Also, there doesn't seem to be much arguing anywhere but that it will increase unemployment. The question is whether it will be 300,000 or 700,000. But there is generally a pretty solid feeling even among those who support the decontrol program that it will increase unemployment.

Now, the question is, in the light of the announcement of the Federal Reserve Board as to its monetary targets, if oil decontrol occurs, what does this do to the economy?

And second, what kind of a monetary policy and fiscal policy should we follow if decontrol occurs?

Mr. THUROW. If you have an increase in the price of oil, it is essentially like having a tax increase, and the appropriate remedy is either a formal tax decrease on the part of the Federal Government or easier monetary policies. Whatever you think the right level of a budget surplus or deficit was prior to that oil increase, or whatever you think the right monetary policies were prior to that oil increase, they are not right after it. You are going to need more stimulation if at the same time you are going to decontrol oil.

Chairman HUMPHREY. I think it is clear that decontrol and the rise in OPEC prices will affect all sectors of the economy. I mean it isn't just the price of oil; it isn't just the price of gasoline; it isn't just the CPI, the Consumer Price Index; it is going to affect the entire economic structure, including the Federal budget.

Mr. KLUTZNICK. Mr. Chairman, it seems to me that this is an appropriate place to recognize that on the short run that, of course, is correct. The thing that is missing in this scenario is the longrun picture. And here I think Congress must share the responsibility. An excellent lecture on this subject was recently delivered by Philip Sporn, and copies of this lecture have been distributed by Kuhn, Leob & Co. I would recommend that it be carefully studied.

Business tends to discount certain acts if it sees some hope. But when it sees no hope, it doesn't discount.

Now, the idea that we are going to really get a solution of our present situation by increasing prices, that's an invitation to OPEC, of course. It is an openhanded invitation to OPEC to say to us imme-diately, if you can increase the price by $5 a barrel, well, you can pay us $3 a barrel. And I think it will have that effect without a doubt.

But what is missing is a constructive long-term program to get out of this bind. Otherwise what is going to happen with decontrol, and

what is going to happen with OPEC will happen again next year and the year after. And unless there is a first-class conservation program, a first-class program that looks toward the use of alternative sources, including our coal supply and things of that sort, I think we are going to end up with having this as a repetitive process.

And of course, Professor Thurow is completely right, it is a tax on the economy, and it can only be offset by another reduction in taxes and an increase in the deficit. The President has even hinted at the fact that there might have to be another tax cut. The Secretary doesn't seem to be looking that way immediately. But I think this is a part of the whole ball of wax on the question of energy, where—I believe that we have not moved.

Chairman HUMPHREY. May I say, with a degree of optimism, that we are moving. The Senate has been moving on legislation very rapidly, as a matter of fact. We have eight or nine major bills on the calendar, and three of them have already been passed in the last of this week. And I would expect that there would be more of them. And the big bill, of course, the big one is ERDA research and development authorizations and ultimately appropriations for the development of alternative sources of fuel, as well as the energy conservation measures, which I'm convinced we are going to take.

Now, the House conservation measure was very weak, we think on this side of the Capitol. But it was a structure, at least. We got something through the House.

Senator Javits, I'm taking some time here. I know you wanted to look over some of the testimony. Would you like to question our witnesses?

Senator JAVITS. I know one of our witnesses very well, Mr. Klutznick. And I know of his interest and concern with the real estate field. He has already given us information on that score.

I had a meeting last night in New York dealing with the availability of capital. One of the questions which came up in that meeting was the financing of housing; whether there were adequate resources to finance housing, and whose fault it was that there should be such a shortfall in the housing field. An effort was made to lay responsibility at the door of high construction costs and the trade unions. The argument was made that, on the whole, the mortgage market had given the homeowner a break over a sustained period of time. Mortgage money was still available because large thrift institutions had certain mandatory requirements for putting out mortgage money. One argument attributed the difficulty in respect to housing to high costs, especially labor cost. In the frame of reference of the witnesses' testimony, perhaps with Mr. Klutznick leading off—being very prominent and knowledgeable in this field—we might get some thoughts as to whether housing construction suffers more from high construction costs or interest rates.

Mr. KLUTZNICK. Senator, there is a point at which availability of mortgage money is not a factor. When money costs too much, it is no good to the large buying public. This is one of the things that happened when the market went down. It wasn't that there wasn't money available; there was money available at 14 percent. That

meant that the family couldn't buy the house—the family who needed it. You know, housing is like the automobile business. There are more Chevrolets sold than there are Cadillacs, when they are sold. And housing is the same way. So it's not only a question of availability, which is a question of the price at which it is available.

We have, and there is in the country now, a growing scandal over one of the most progressive measures that I think the Congress passed in the housing field. And that was the declining interest rate mortgage for disadvantaged families.

Families who couldn't afford going interest rates. And everybody said that the 235 program and the 236 program just wasn't working. That wasn't so. The fact is, the idea was good, but it was administered badly. It was given to the wrong people, and too rapidly pushed out without proper administration. And I'm afraid that we are going to have to go to an interest subsidy even when there are adjustments. And with good administration, we might revive the market.

It is also true, Senator—and you have put your finger on it—that at $40,000 and $50,000 a house, even with today's value of the dollar, the number of families that can afford to buy is very few. We found in one of our developments, for example, that it took 1.6 percent wage earners—which meant there generally had to be at least two wage earners—to buy a modest house at $28,000 to $30,000.

So it does seem that there are a number of factors—production costs is one of them—and in my earlier testimony, I pointed to the fact that there are many impediments to production generally—and I think we have to look at the effects that these impediments may have on cost.

I think you have a combination of things here. One, there were a lot of unsold houses hanging over the market that had to be gotten rid of before there could be any new stimulus to production.

Second, the decline in the availability of mortgage money was a factor. Money is now more available, but the price at which it has become available is not yet good enough.

And third, for the people who are in great need of houses, even at the lowest interest rate, and with a 40-year life of the mortgage—which is about as far as you can go without having a person in the family die before they pay off their loan—and at a half of one percent repayment annually—you can't go much further than that, you have to pay something back on the principal or you never own it—at the interest rate that I can see in the immediate future, the real market wouldn't be reached without an interest subsidy. That is my judgment.

Senator JAVITS. Is there any comment from the other panelists?

Mr. THUROW. The production costs that you mentioned are certainly important, but if you were to look at the downturn in housing in this recession, and then compare it with the downturn in housing in previous recessions, it is not a surprise. The tight money policies in 1974 had just about the effect that econometric equations would have predicted.

High production costs may have a role, but I think you can trace a good percentage of the downturn to interest rates and credit avail-

ability. Such equations and econometric models were not doing badly in 1974. They foresaw the downturn in housing. It did not come as a surprise to anybody who was watching the market.

Senator JAVITS. And so you could not rely upon the so-called multitude news transactions theory in order to correct the housing market?

In other words, the fact that a lot of houses are on the market unsold did not break the price of housing or make such a glut of mortgage money as to enable the casual run-of-the-mill individual to acquire a home. Is that correct?

Mr. THUROW. That is correct. If you look at current rates, credit availability has clearly gone up since October 1974, but if you look at the interest rates, they are a little bit down, but not a great deal.

Senator JAVITS. Is there no such great compulsion for the private institutions to invest in mortgages to correct that situation?

Mr. THUROW. I do not think so, no, sir.

Senator JAVITS. And do you agree with Mr. Klutznick, therefore, that to correct it you will either need to have a good subsidy for interest or go in for direct lending?

Mr. THUROW. I think it depends partly on what relative weight you are going to put on monetary and fiscal policies to control the economy. Ever since the beginning of the Vietnam war we have been putting too much weight on monetary policies and not enough weight on fiscal policies. And during periods when the Government should be restricting the economy we should be doing it with the Federal surpluses that Mr. Klutznick was talking about earlier, and running much easier monetary policies.

If we were doing that I think you might be able to restimulate the housing market without interest subsidies, but it does require that Congress and the President be willing to run a very different set of fiscal policies than they have run over the last 10 or 15 years.

Senator JAVITS. I always hear about monetary and fiscal policy in exactly the way in which you handle it, on the demand side. What about the supply side?

In other words, you hear a lot of talk about tax reform. But are we taxing ourselves enough and broadly enough to maintain this system? One of the things that was discussed last night, for example, was whether or not you had to crank in some kind of a value added tax so as to be fair to everybody while providing stimulation. The popular theory that we are only willing to void tax cuts here, I think is incorrect. I think that has been blown out of the water by the fact that you have less buying power now than you did before these tax cuts. Prices just chew you up a lot.

So the question is whether, in rethinking the whole system—which you are asking us to do—should we also rethink the supply side of money and credit, as well as the demand side.

Mr. THUROW. I think that is absolutely right.

I think it would be terribly unfair to accuse Congress of not being willing to raise taxes, because the social security tax has gone up by a very large amount, and that is a tax increase. Congress was willing to vote tax increases, and I was not implying the opposite at all. But what I am saying is that if you are willing to put more weight on fiscal policies, then I think you could have substantially lower interest rates and easier monetary policy and handle some of these

capital needs and housing needs without the direct kind of Government subsidy that might be necessary if we insist on controlling the economy through the monetary variables.

When you bear in mind that in some of the high cost markets the costs of a house increased 30 to 50 percent from 1971 to 1975. I am taking the figure out of the air on the average—in 1971 in the first half of the year there was a placement of $17.2 billion. That moved up to as high as $32.1 billion in 1973.

Now, that meant many fewer units in 1973—$26 billion placement in 1972. In 1974, it dropped to $22.5 billion, which meant still fewer units. And in the first half of 1975, with unsold houses all over the lot, and allegedly bottoming out of the recession, there was a mortgage placement of only $13.7 billion. Which merely means that the ability to buy—it is not that everybody has a house, but the ability to buy is a factor at the price and the availability of the cost of money.

Now, while I agree with my colleague that Congress does raise taxes now and then, the fact is that I am not sure it raises them at the right time and in the right quantity.

When you end up with deficits every year in the last 15 years except 3, and not very much surplus, then it proposed that you have a valid tax, and so forth, may be something that will have to be considered at the right time.

Senator JAVITS. I had in mind the allocation of the tax burden, that is all I am saying. Everything has got to be on the table. You have to be sure the corporations are paying their taxes, be they foreign taxes, credit, or whatever else is charged against them. At the same time you have to be sure that we are all paying our taxes, and that we are sustaining the credit worthiness of this country. All of you seem to agree and all the participants last night seemed to agree, that it is very essential to have a Federal budget which is credit worthy.

You cannot whip credit out of the ground. If you are spending it you have got to raise it. We know that even appropriating everybody's property, or everybody's income, does not begin to solve any of these problems. All it does is leave you with one arm instead of two with which to solve your problems.

So I just raise this question in order to get your feeling.

Is there any feeling in this particular panel respecting the fact that we cannot build the necessary capital in order to deal with our problems in the next, say, 5 years? Are we capital short? Are we engaged in the necessary activities which will result in adequate capital formulation?

Mr. KLUTZNICK. Well, I would refer you to some figures that Secretary Simon used in his last article. It depends upon how you look at the problem. I think he is correct that large business is not generating enough in material profits to update its plant, and to provide for the future. I am not sure, however, that in the aggregate the evidence at the moment supports the conclusion that the market cannot absorb the deficits needed to finance and refinance the public debt and at the same time still handle the financing which business needs now.

I think, looking down the road a few years, that you may have a very important point.

Mr. THUROW. I think it depends a little bit on how many years are a few years. If you take the current scenario where the economy is still going to be operating at a 6-percent unemployment rate by 1980, it is clear that capital shortages are not a problem for the seventies. It is a problem for the eighties. The problem for the seventies is going to be basically where do you get enough demand to put everybody back to work. Investments are a perfectly good way, and maybe even a superior way. If we can get an investment boom going, we could put the economy back to work, create jobs, and raise the productive capacity of the economy.

Mr. DUBOIS. I would like to respond to Senator Javits' question on housing, because I relate to housing from a different standpoint from the Senator, I believe, and my associates here at the table.

Being from a rural area, and an observer of housing in rural America, basically I do not believe that we have unused housing, housing that has been constructed and has not been occupied. What we really need in rural America is more housing. And our basic problem in this is the fact that the figures developed by this committee indicate that a medium priced home was $41,000. And the salary to maintain and afford that home was $23,000.

Well, the medium priced house, I think, in this country is $38,000, and the medium income is $12,500. When you come back to my community, or to rural communities which I am familiar with, if both members—husband and the wife—are working, they are very fortunate if they make $12,500 or $15,000 or $16,000. But housing costs $35,000 or $45,000. And believe you me, as a banker, we are hard put to know how to find the answers. We are taking care of some of it. But if interest was free today, many of our people in this country could not afford housing. The inflation has created so much havoc on the part of so many people that we are going to be hard put, pressed, for adequate housing for rural America for a long time to come unless we can find some solution.

Chairman HUMPHREY. I am very pleased at your comment, Mr. DuBois.

One of the problems that we have down here is these generalized figures. They do not even relate particularly in the housing area to the kinds of housing that are required. In our part of the country, for example, housing is more costly, simply because we have to build a home that has more insulation, and can withstand tougher weather, that has a better heating system, and has a better roof. It is a stronger structure, as compared to, let us say, building a home in Florida or in southern California. And incomes are so different—you know you are down here in Washington, and this is a high-cost city, I know, and yet income levels for, let us say, commercial people in this city, people that work in the Government offices, and in the private industry, are substantially higher than they are at home. In fact, they are so much higher that it is incredible. When I go back to my little town where we have our home, and I talk about what the Government calls the poverty income here, they talk about that as a reasonably good income. I really get worked over, as you know, by some of my rural friends who say, well, now, Humphrey, you are talking about people being poor when they have got $10,000. We worked all last year, my wife and I, on 240 acres, or 360 acres of farmland, planted it, and harvested

and everything else, and we did not earn an income of $10,000. And we have got an investment here of $150,000 or $250,000 in this land and this equipment. And we put in 16 hours a day. We do not have 2 weeks vacation, and we get no sick leave.

Some Members of Congress say they ought to get our income raised. I want to tell you, when I go home to Minnesota and tell them that my salary is $42,500, and that I am having a hard time getting by on it, they look at me and say, obviously there is something wrong with you, Humphrey.

So that is not exactly what you approach your constituents with. I think that we forget that 65 percent of the people in this country have incomes under $15,000 a year.

Mr. KLUTZNICK. Mr. Chairman, I think Mr. Dubois and you have made a very important point. But our company, my old company operates across the country. The worst situation I think is in Manhattan, in terms of costs and income.

Chairman HUMPHREY. Yes.

Mr. KLUTZNICK. I at least want to commend your State, it has some of the best workmen in this business in the country.

The problem is substantially the same in high cost and low cost areas, because incomes tend to relate themselves to total cost. The only people who are free are the really wealthy people who have any wealth left. Aside from that, the market is bad across the country.

Chairman HUMPHREY. Let me get to you, Mr. DuBois, if I can, with a couple of questions.

You mentioned here that your survey turned up the fact that rural bankers felt there were a number of steps which could be taken to help them meet the future credit needs of agriculture. Now, let me just take a moment on that. Did I understand you to say you thought as of the present that the rural banking structure was meeting the the credit needs of agriculture?

Mr. DUBOIS. That is correct.

Chairman HUMPHREY. You are looking down the road to what the rural credit future needs will be. Could you give us an idea of what—in your judgment as a banker and representing bankers, and you are both—it costs to establish a productive farm that has some economic viability; in other words, a farm that will provide a reasonable standard of living for the owners and the occupants.

Mr. DUBOIS. I think today in the area that I am most familiar with, which would be central Minnesota, which is a dairy area, as you well know, a viable farm, a farm that should be successful, should be about 240 acres. And it is selling for anywhere from $400 to $600 an acre. So you could very easily have $100,000 or $125,000 worth of investment. And your livestock and machinery costs, and operating expense could very easily require another $100,000. So you are talking about a quarter of a million dollars to get into farming.

So when a young person comes to us and says, I want to get into farming, I have educated myself in the field, and I have this much, almost invariably we have to say to that man, the arithmetic says you cannot be successful with what you have, because the profitability is not there to maintain the debt that you are going to have to maintain.

Chairman HUMPHREY. Do you not see the situation in terms of a father passing a farm on to another member of the family, rather than being able to go out and finance an entirely new operation?

Mr DUBOIS. We are finding more and more of that, and thankfully, because that perpetuates family farming. The family farm gives the younger man a chance to come in.

But we are coming into another area which is very devastating to the successor of the farm. And this is the matter of tax. At the time of death of the father, there are assets that have been inflated because of the various effects of our economy and the actions of our Government, and all of a sudden father checks out. And taxation that occurs at this level is going to force liquidation of that farm, and it is going to drive that young farmer off his rightful opportunity.

Chairman HUMPHREY. We must look into this matter. Because this is an important matter. With these new inflated land values and other increased costs of equipment and all, it is going to play havoc with the family farm development which survives today because of what I think I properly said earlier; namely, the farm passes from father to son or uncle or nephew or some family arrangement where they pass on the land.

According to the Federal Reserve Bank of Chicago, Mr. DuBois, outstanding agricultural loans expanded fastest at the Federal land bank, they were up 25 percent; at the production credit associations, loans were up 22 percent. Does this increased role by the Federal land bank and production credit association mean that we will see lower interest rates in the future in agriculture?

Mr. DUBOIS. I think interest rates for agriculture are going to be dependent a great deal upon Federal Reserve policy, and I believe the actions of Congress. I think that we are caught up in a period where we are probably never going to see low interest rates again as we experienced them in the past. And I think the trend is going to be, because of the cost of raw material, that is, money—the deposits that banks have, or financial institutions have, being fixed at 6½ or 7 percent, or whatever the average turns out to be—that if a financial institution is going to stay in business and is going to be able to service its area, it has to charge the necessary rate. Therefore, I think that rates, whether we like it or not, are up, and I think rather than move down significantly the trend will be up. I do not believe rates will come off.

Chairman HUMPHREY. The growth of the activity of the Federal land bank and production credit associations, is this due in part to the fact that they are exempt from usury laws, and can tap into the central money market?

Mr. DUBOIS. I think almost entirely. I think that the usuary laws in some States have almost forced many of us out of lending for any lengthy period. We have had to stay short because we have had to pay rather high interest, and we are limited to what we can charge. Federal land banks because they are exempt from usuary laws, can charge the higher rate, and as a result, they can go to the market and buy the funds necessary and therefore accelerate their loan totals.

Chairman HUMPHREY. I had a number of questions on the Rural Development Act, but I think you have touched those in your testimony. You have made note of the fact that the community develop-

ent loans have been slow in coming as have the kind of insured loans and guaranteed loans that are provided for in the Rural Development Act.

Your survey turned up the fact that the rural bankers felt that there were a number of steps which could be taken to help them meet the future credit needs of agriculture. Apparently those credit needs are going to be rather extensive, and indeed very heavy. These included, according to what you said, closer cooperation of Government agencies such as Farmers Home Administration, Federal land bank, and the PCA's, the production credit associations. What specific problems have rural bankers encountered in making use of these agencies, Mr. DuBois, and have you found that these agencies are not as helpful when money tightens up? In other words, are they fair weather friends? I put it to the line to you.

Mr. DuBois. Senator, I think basically that the production credit and the Federal land banks are to a degree competitors of private financial institutions. They are after their share of the market, and they are fighting for profitability. They want to make their organizations grow. So therefore I think they are competitive.

Now, I think in the future we are going to find it necessary that we use the collective strength of the Federal credit agencies, the Farm Credit Administration, the rural banking system, and other financial institutions as we go down the road providing credit needs for expanding agriculture at much higher prices.

Chairman Humphrey. You spoke of these correspondent banks, Mr. DuBois. You noted a number of steps which Congress and the Federal Reserve could take to insure that rural banking remains a sound source of credit for agriculture. Now, you traditionally have placed deposit accounts with correspondent banks in urban areas, in order to provide access to a variety of banking services. I am curious, therefore, why you urge that existing correspondent banking practices be revised to reduce the proportion of funds absorbed by the correspondent bank. Exactly what do you mean by this?

Mr. DuBois. Traditionally banking has paid for services supplied by its correspondent bank by maintaining an adequate balance, which the correspondent bank used for its own purpose, investments or or loans or what have you. So I feel we need—and I think it will come to be—to price the services that are provided by a correspondent bank to a country bank, a rural bank or a community bank, on the basis of what a reasonable charge should be, and that our balances should be relatively free to invest in our communities.

Chairman Humphrey. In other words, to pay your costs and the fees that are required, and to be able to maintain the deposits, the capital in our own bank for the needs of your rural communities?

Mr. DuBois. It will reduce the amount that we have on deposit with the correspondent bank and we will be permitted to lend more to our immediate community.

Chairman Humphrey. A final question just across the board. Secretary Simon has spent a great deal of time emphasizing the danger of crowding out, which Senator Javits mentioned, crowding out the private borrower from the money market in this rather precarious time in which we live where there are heavy Federal deficits. And by the way, those deficits will mount if the unemployment rate goes up.

because every 1 percent increase in unemployment results in a tremendous loss of revenue; I think it is about $16 billion. And then you must add on top of that the social service costs that come in for food stamps and unemployment compensation. So on the one hand you lose revenues and on the other hand you increase Government costs. My point is, have you seen any evidence that the Treasury financing of our deficits so far this year has lead to any crowding out?

Mr. THUROW. I think the answer is no.

Mr. KLUTZNICK. No. And it looks—he is crying wolf in my judgment.

Chairman HUMPHREY. What is your view of this, Mr. DuBois.

Mr. DUBOIS. I cannot see that there has been any crowding out. In the rural areas we have a deposit growth which has made more money available, a rather significant deposit growth, because of two or three factors. One of them is the fact that interest rates at banks are a bargain today; they are one of the best investments available; they have the security of banking capital structure and Federal Deposit Insurance Corporation. I think that people have become weaned from get-rich schemes that have been going around and the quack investments at high rates. I think there is a thriftiness that is caused by resistance to prices they are asked to pay. So I think these factors are increasing deposits, not only in country banks, but in the thrift institutions across the country.

Chairman HUMPHREY. Might I ask Mr. Thurow and Mr. Klutznick, do you see any danger of this crowding out in the next year?

Mr. KLUTZNICK. I spent some time in the investment firm in Wall Street, of which I am a limited partner. And I take their judgment rather than mine. They have been able to accommodate the demand. And it doesn't—if the economy continues even at its present level with the kind of growth that should come from modest improvement, they do not see any crowding out.

Chairman HUMPHREY. Mr. Thurow.

Mr. THUROW. I do not think there will be any crowding out in the next year either.

Chairman HUMPHREY. Gentlemen, I would love to keep you here, because you are some of the most interesting witnesses we have had. I want to thank you very much.

And may I say that we take the liberty of sharing this testimony with every Member of the Congress, as you know, through our Joint Economic Committee Newsletter which we put out weekly. We keep our colleagues up to date; every financial writer, or most of them get it too, and mayors and the Governors; so we are trying to use these hearings as a way of communicating to a much broader clientele than just the Members of Congress.

Mr. DuBois, we are going to take the liberty of taking your testimony, because it is valuable to rural America, and make a special newsletter of it. I believe that the Independent Bankers Association has performed a very valuable service in your survey and your recommendations. I cannot thank you enough.

I might add, for the other witnesses, that the Rural Development Act was developed in the closest cooperation with the Independent Bankers Association. And it is my judgment that if the Government will cooperate in the implementation of that act with your bankers, and other financial institutions, we can get a tremendous improvement in rural America, not just on the farms. We have the Federal Land

Bank, and we have the production credit associations and we have the Farmers Home Administration for operating loans, and so forth, for the farmer too.

But rural America, the rural community, the community of 10,000, 5,000, or even 2,500 population, is a part of the structure of our country which is beginning to take a new significance because of the outflow of people now from our cities, not just into the traditional, what we call suburbs, but really beyond the suburbs into rural America. So we need this credit base, and we need it desperately.

We are also going to be looking forward to further studies on capital formation, because I am concerned about this subject, about funding solutions to the transportation problems of the country, and to the energy problems that our country faces. Anything that you can offer us in any papers that you have written, any studies that you have written—Mr. Thurow, for example, and you, Mr. Klutznick and you, Mr. DuBois—will be helpful to us. Because while I am not one that believes that the problem is immediate, I do think that we have to be cognizant of the probabilities and the possibilities.

Mr. KLUTZNICK. Mr. Chairman, just before you leave, may I thank you for listening to us. I guess we have learned as much as we have given. It is always a delight to come before you.

Chairman HUMPHREY. Thank you very much, gentlemen, I appreciate it.

The meeting is adjourned.

[Whereupon, at 12:05 p.m., the committee adjourned, subject to call of the Chair.]